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The Regulation of Electronic Money Institutions in the United Kingdom

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Abstract

The Electronic Money Directives of the European Union, concerned with the regulation and prudential supervision of electronic money institutions, have now been implemented in the United Kingdom. The implementing provisions are found in a number of disparate legislative instruments. This article identifies the various legislative instruments concerned and articulates the key elements of the regulatory regime that is established. It also considers some of the potential difficulties in the way of achieving the objectives of the regulatory regime, particularly enhancing consumer confidence in e-money products which are compared with the use of credit and debit cards as means of payment for e-commerce transactions.

1. Introduction

Since the onset of Internet e-commerce, many schemes have been devised to provide an electronic payment mechanism specifically tailored for electronic transactions. Although generic expressions such as 'e-money', 'e-cash' or 'digital cash' are used in relation to these schemes, in reality the schemes are diverse and operate in a number of different formats.ⁱ In general, the schemes involve the creation of digital units or tokens of value in a particular currency (or possibly multiple currencies) that are stored on an electronic device such as a computer including the 'digital coin' or a smart card and can be transferred from one party, for example a buyer, to another, for example, a seller.ⁱⁱ The structural details tend to vary. For instance, a scheme may take a form sometimes called 'identified e-money' or the like in which case the identities of the parties, especially the payer who would have obtained the money from the originator or service provider, are revealed in the payment operation. The identity of the payee can be more readily established when the e-money is exchanged for actual money or value. On the other hand, the scheme may take the form of 'anonymous e-money' when the identity of the payer is not revealed as part of the payment operation which in effect operates like an exchange of cash. This is, arguably, the type of scheme that can be nearly accurately called digital 'cash'.

Another dimension of difference between the schemes is whether they operate on an 'on-line' or 'off-line' basis. A scheme operates on an on-line basis when, in order to complete payment by one party to another, it is necessary to contact either the originator of the scheme or the relevant authorised institution via a modem or network. A scheme operates on an off-line basis when the payment transaction can be concluded directly between the parties without the involvement of the originator or other institution.ⁱⁱⁱ

Although some of the early attempts to operate electronic money schemes were rather unsuccessful, there still remains a lot of interest in electronic money within the financial services and telecommunications industries as well as by regulatory authorities.^{iv} From the regulatory perspective, the use of digital cash and e-money

generally raises a number of policy and transactional legal issues including the following:

1. Legal tender – whether the units of value created under these schemes constitute legal tender as well as the effect of their introduction and operation on the fiscal situation and policy of concerned countries.
2. The effect of the schemes constituting digital cash in particular on money laundering controls and policy.
3. The legal responsibilities of the originator: e.g. matters concerning its solvency and real value supporting the digital value represented in the system; what happens if the scheme is withdrawn?
4. The legal responsibilities of other participating institutions – especially matters concerning their solvency.
5. What is the position of the originator of the scheme vis-à-vis other participating institutions/banks?
6. The liabilities of the originator and participating institutions/banks on the one hand and either the customer or even the supplier on the other.
7. Effect of the method of payment in the event of contractual disputes between the payer (customer/buyer) and payee (supplier).

From early days, the European Union had been engaged in efforts to address some of these matters. This article discusses the implementation of the [Electronic Money Directive](#) (2000/46/EC) and associated instruments in the United Kingdom. Considering that the main mode of payment for online consumer transactions especially hitherto has been by credit cards, there is also an examination of some of the legal issues concerning credit card payments for e-commerce transactions.

2. Mapping the Regulatory Framework: An Overview

Generally speaking, the issuing of electronic money or the operation of an electronic money scheme *per se* does not fall within the general and usual regulation of banking institutions. This is because the simple operation of an electronic money scheme does not constitute the taking of deposits or lending or finance. On the other hand, there are genuine reasons for wanting to regulate electronic money schemes. In the first instance, unregulated and unchecked issuance of electronic money may impact the ability of central banking authorities to monitor money supply and to implement monetary policy effectively. Secondly, there is concern of the need for market confidence in such schemes as well as the protection of consumers and merchants that use electronic money in the conduct of business – particularly in respect of the potential for systemic failure of such schemes. In the context of the free market of the European Union, there are also questions about the ability of an electronic money operator/issuer

licensed in one EU member state to operate in another state and, more broadly, of an operator licensed in *any* country to operate in another.

In the European Union, the regulatory scheme is based primarily on two directives: [Directive 2000/46/EC on the taking up, pursuit of and prudential supervision of the business of electronic money institutions](#) often referred to as the 'Electronic Money Directive' and [Directive 2000/28/EC](#) which in turn amends [Directive 2000/12/EC relating to the taking up and pursuit of the business of credit institutions](#), often referred to as the 'Banking Directive', by extending the definition of credit institution to include electronic money institutions.^v In summary, the objectives of the primary [Electronic Money Directive](#) include (a) to protect consumers and ensure bearer confidence through the implementation of rules for safeguarding the financial integrity and stability of electronic money institutions and (b) allowing an electronic money institution licensed in one EU member state to issue electronic money throughout the European Union either through cross-border distance services or by establishing a branch in another member state or both - sometimes referred to as a 'single passport' or 'European passport'.

The [Electronic Money Directive](#) has now been implemented in the United Kingdom. The approach adopted has been to create a separate regulatory regime, in force since April 2002, for electronic money institutions which, nevertheless, is linked to the general regulatory scheme concerning finance and other institutions under [The Financial Services and Markets Act 2000](#) (the 'FSMA 2000'). Accordingly a number of subsidiary legislative instruments have been introduced to amend the FSMA 2000 and other relevant legislation.

The implementation of the [Electronic Money Directive](#) in the United Kingdom actually makes for an interesting study as it involves a vortex of subsidiary legislative instruments operating under the [FSMA 2000](#). The key instruments implementing the relevant Directives in the UK are: (a) [The Financial Services and Markets Act 2000 \(Regulated Activities\) Order 2001](#)^{vi} (the 'Regulated Activities Order') as amended by, firstly, SI 2001/3544 and especially by [The Financial Services and Markets Act 2000 \(Regulated Activities\) \(Amendment\) Order 2002](#) (SI 2002/682). The [Regulated Activities Order](#) actually specifies 'regulated activities' and 'investments' for the purposes of the [FSMA 2000](#) but had not taken account, originally, of the issuance of electronic money; [SI 2002/682](#) amends it by inserting necessary references for electronic money}; and (b) [The Electronic Money \(Miscellaneous Amendments\) Regulations 2002](#) (SI 2002/765).

In addition to the [FSMA 2000](#) and the secondary legislation, the *Financial Services Authority* ("FSA")'s *Handbook of Rules and Guidance* contains a number of *Modules* providing guidelines and amplifications of the regulatory provisions concerning e-money institutions. The principal Module is the [Sourcebook for Electronic Money Issuers](#), known as *ELM*, which contains more detailed provisions implementing aspects of the [Electronic Money Directive](#) and the Banking Directive. Other relevant Modules include the *General Provisions*

(*GEN*), the *Threshold Conditions (COND)* and the *Authorisation (AUTH)* and *Supervision (SUP) Manuals*.

Under the United Kingdom regulatory scheme, the issuing of electronic money is now classified as a ‘regulated activity’ under the [FSMA 2000](#) and ‘electronic money firms’ are regarded as ‘credit institutions’ regulated similarly to banks though with less stringent requirements. ‘Electronic money’ is defined in Article 3(1) of the [Regulated Activities Order](#) (as amended by [SI 2002/682](#))^{vii} as ‘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.’ In that definition, electronic money is defined in a technology-neutral manner taking account of the fact that there is a variety of electronic money schemes. It has been observed^{viii} that this definition contains a slight divergence from that in the [Electronic Money Directive](#) in that the second criterion, ‘issued on receipt of funds’, omits the phrase ‘of an amount not less than the monetary value issued’ which is included in the second criterion in the Directive.^{ix} The reason for this is a desire by the government to avoid creating a loophole that electronic money that is issued at a discount might fall outside the definition of ‘electronic money’ and could therefore possibly escape the regulatory framework established to govern electronic money issuers. The retention of the phrase ‘issued on receipt of funds’ is thought to ensure that pre-paid electronic money remains within the definition while the words omitted ensure that no loophole is created in respect of electronic money issued at a discount.^x

Article 9B^{xi} of the [Regulated Activities Order](#) confirms that issuing electronic money is a regulated activity hence subjecting electronic money firms to s.19 [FSMA 2000](#) which provides that no person may carry on a regulated activity in the United Kingdom unless he is an *authorised* or *exempt* person. By Article 74A^{xii} of the [Regulated Activities Order](#) ‘electronic money’ is now listed as a specified investment. However, by Article 64^{xiii} of the [Regulated Activities Order](#), simply *agreeing* to issue electronic money is not a regulated activity. Another notable feature is that by Art 9A^{xiv} of the [Regulated Activities Order](#), a sum immediately exchanged for electronic money is not regarded as a ‘deposit’.

3. When and to whom do the Regulatory Provisions Apply?

The [Electronic Money Directive](#) requires Member states to prohibit persons or undertakings that are not credit institutions from carrying on the business of issuing electronic money.^{xv} It is noted in § 1.3.1[G] of *ELM* that the purpose of this is ‘to ensure that only persons who are subject to a prudential regime designed to deal with the risks of issuing e-money engage in that activity.’ In the first place, the general prohibition in s. 19 [FSMA 2000](#) provides that no person may carry on a regulated activity (now including issuing electronic money) in the United Kingdom or purport to do so unless he is an authorised or an exempt person. Section 40(1) of the same Act provides that those who may apply for permission to carry on one or more regulated activities include an individual, a body corporate, a partnership, or an unincorporated association. Importantly, however, an amendment to Paragraph 1(2) of Schedule 6 to the [FSMA 2000](#)^{xvi}

(*threshold conditions*) requires that an applicant for permission to carry on the activity of issuing e-money must be either a body corporate or a partnership - hence the provisions generally concern e-money *firms*. This amendment is reflected in the provisions of *ELM* and in § 2.1 of *COND*,

Whilst the provisions of *ELM* generally apply potentially to every firm that wishes to issue e-money, *ELM* actually identifies various kinds of firm. The result is that not *all* the rules of *ELM* apply to every firm that wishes to issue e-money. The parts of *ELM* that apply to a particular firm depend on the categorisation into which the firm falls and are summarised in chapter 1 of *ELM*. The types of electronic money issuers^{xvii} to which various parts of *ELM* apply include, in the first place, an *e-money firm*, which is defined in the [Glossary of Definitions](#) (“Glossary”) as a firm whose permitted activities include issuing e-money. Thus, ‘e-money firm’ seems to be a generic appellation, under the United Kingdom regime, for electronic money issuers. This would include banks and building societies that also issue electronic money. On the other hand, the *ELM* also applies, indeed predominantly, to an ‘ELMI’, which is defined in the [Glossary](#) as an e-money firm that is not a bank, building society, incoming EEA firm or incoming Treaty firm. The definition of ‘ELMI’ in the [Glossary](#) requires some comparison to the definition of ‘electronic money institution’ (also often abbreviated as ‘ELMI’ or sometimes ‘EMI’) in the [Electronic Money Directive](#) as the latter refers to “an undertaking or any other legal person, other than a credit institution ... that issues means of payment in the form of electronic money”. Both provisions reflect the fact that the regulatory scheme is aimed predominantly at electronic money issuers that are not banks or building societies and ‘ELMI’ usually refers to such non-bank issuers of electronic money.

Further sub-categorisations identified in *ELM* include an ELMI that is not a ‘lead regulated firm’^{xviii}; a *small e-money issuer* which is, in simple terms for present purposes, a firm that issues e-money on a limited scale and is subject to stated conditions;^{xix} an e-money firm that is either an *incoming EEA firm* or an *incoming Treaty firm*;^{xx} and, an ELMI that is established outside the EEA - although chapters 2, 3 and 7 of *ELM* do not apply to it if such a firm is also a lead regulated firm. The rules in *ELM* have the consequence, as expressly stated, that if a firm (other than a building society) wishes to have a Part IV permission that includes issuing electronic money, it must either become an ELMI accepting the restrictions that come with that status^{xxi} or become a bank.^{xxii}

As the taking of deposits is a regulated activity banks are required to be authorised or exempt in order to carry out that and similar regulated activities lawfully. Banks, as such, are thus already subject to regulation in accordance with the [FSMA 2000](#) and relevant banking legislation and banking codes. Nevertheless a bank, indeed any full credit institution, which wishes to engage in the regulated activity of issuing electronic money, must apply for permission under Part IV of the [FSMA 2000](#) to do so. Electronic money issuers (‘ELMIs’) that are not banks, except small e-money issuers, will require permission under Part IV of the [FSMA 2000](#) to carry out the regulated activity of issuing electronic money. The *Authorisation Manual (AUTH)* provides guidance for ascertaining what activities fall within the scope of the [FSMA 2000](#) especially to persons who wish to find

out whether they need to be authorised, in respect of what regulated activities and also as to the scope of existing permission (*AUTH* § 2.1). It also reiterates the provisions of s. 23 [FSMA 2000](#) that it is an offence, subject to a maximum of two years imprisonment and an unlimited fine, for a person to carry out activities in breach of the general prohibition of s. 19 [FSMA 2000](#). It is a defence, however, for the person to show that ‘he took all reasonable precautions and exercised all due diligence to avoid committing the offence’. In accordance with sections 26-29 of the [FSMA 2000](#) on the other hand, some agreements in contravention of the general prohibition could be unenforceable. (*AUTH* § 2.2).

The *Authorisation Manual* also reiterates, as provided in s. 22 [FSMA 2000](#), that for an activity to be a regulated activity it must be carried on ‘by way of business.’ This is called ‘the business element’ and, what constitutes the business element, subjecting an activity to regulation, actually depends on the kind of activity concerned. Whilst [SI 2001/1177](#)^{xxiii} gives indications as to what constitutes carrying on an activity by way of business in respect of deposit taking, investment business and managing investments, it does not give similar indication in respect of the activity of issuing electronic money. Neither does *Appendix 3*^{xxiv} to the *Authorisation Manual* – which provides guidance on the scope of the regulated activity of issuing e-money – give indications of when the activity of issuing electronic money is carried on by way of business. The *Authorisation Manual* itself confirms that the business element for other regulated activities not specifically mentioned in [SI 2001/1177](#) ‘is that the activities are carried on by way of business.’^{xxv} It gives a little amplification in providing that determining whether or not a particular activity is carried on by way of business is ultimately a question of judgment taking account of factors including: the exercise of a commercial element, the scale of the activity and the proportion which that bears to other, unregulated, activities of the same person. It is further stated that none of the factors is likely, however, to be conclusive and that the nature of the particular regulated activity is also relevant.^{xxvi}

It remains to be seen which factors the courts will place greater weight upon in deciding whether a person is carrying on the activity of issuing electronic money ‘by way of business.’ On the other hand, as the regulated activity is *issuing electronic money*, while the issuer or originator of electronic money by way of business will most likely fall within the ambit of the regulatory provisions, a mere *distributor* of electronic money, not being an issuer, would seem to fall outside the ambit as the *FSA* takes the view that references to the issuer of electronic money in the [Regulated Activities Order](#) (as amended by [SI 2002/682](#)) are to the originator and not to distributors.^{xxvii} It is also useful to point out that the issuing of electronic money by a ‘small or local issuer’^{xxviii}, to whom the *FSA* has given a certificate to that effect under Article 9C^{xxix} of the [Regulated Activities Order](#) is not a regulated activity, provided that the certificate has not been revoked.

In addition to the foregoing, the requirement for authorisation under the United Kingdom regulatory regime, in accordance with s. 19 [FSMA 2000](#), is ignited if the regulated activity carried on by way of business is carried on ‘in the *United Kingdom*’. It should not be difficult in many instances to determine whether a regulated activity is being carried on in the United Kingdom, particularly if the

entirety of the process involved is conducted within the United Kingdom. The area of potential difficulty relates to regulated activities that involve some cross-border element. In this respect, and quite significantly, the [FSMA 2000](#) actually extends the meaning of ‘in the United Kingdom’ beyond what would be its normal understanding. Section 418 of that Act sets out five^{xxx} instances, in which a person who would not ordinarily have been regarded as carrying on a regulated activity in the United Kingdom, will, for the purposes of the Act, indeed be regarded as carrying on the activity ‘in the United Kingdom.’ At least four, arguably, of the five listed instances could potentially affect an electronic money issuer or the regulated activity of issuing electronic money.^{xxxi}

Finally, an important issue that has attracted some attention is whether the regulatory regime also applies to the operators of electronic payment schemes that are “account-based”. An account-based scheme is one where a user or owner maintains an electronic account with the operator from which payments may be made to third parties at the owner’s direction. Firstly, in Appendix 3 to the Authorisation Manual, in which the FSA gives some guidance on the scope of the regulated activity of issuing e-money, it is provided in § 3.3.14 [G] that prepaid monetary value that can be spent *without* the involvement of the *issuer* is likely to be e-money. The provision goes on to say, however, that a product does not cease to be e-money merely because the scheme is account based. One of the reasons for the inclusion of account based electronic payment schemes as potentially e-money is expressed in the opinion of HM Treasury, extracted in § 3.3.15 [G] of Appendix 3, as the avoidance of a regulatory gap between e-money and deposit-taking regimes and a difference of treatment between schemes that pose similar regulatory risks. Thus, account based electronic payment schemes are to be treated as falling within the definition of e-money – so long as they are distinct from deposit-taking.

From the perspective of policy and the regulatory objectives, the argument that account-based payment schemes should be regarded as e-money, so long as they are distinct from deposit-taking, does appear strong. However, it should also be considered whether, as a matter of construction, the definition of e-money does indeed cover account based schemes. There is a reasonable argument that it does. The key elements of the definition of e-money are that it is (a) monetary *value* as represented by a claim on the issuer; (b) stored on an electronic device; (c) *issued* on the receipt of funds; and (d) accepted as a means of payment by persons other than the issuer. Under account based schemes, credits to the user’s electronic account in return for money paid to the operator certainly constitute monetary “value” being units, denominated in the currency or currencies of account, that are a capable medium of exchange. The crediting of value to the owner’s electronic account also amounts to a claim on the operator with the case being stronger when the value is redeemable in money, for example, in cash or by funds transfer back to the owner’s bank or credit card account. Secondly, the account is held and accessible electronically and, therefore, the monetary value is stored on an electronic device irrespective of the lack of a physical medium, particularly as the [Glossary](#) defines an “e-money electronic device” to include *any* device that a holder of electronic money uses to hold or to spend or to otherwise use his electronic money.

An apparently less straight-forward point is whether value held in an account-based scheme is “issued”. It is submitted, however, that what constitutes “issue” for this purpose would be the crediting of the owner’s electronic account and the giving of notice to that effect to the owner. It is the intrinsic nature of electronic-money that it consists in the “issuance” of digital information rather than in the issuance of a tangible medium even despite the possible use of e-money cards or “digital coins” which themselves are not e-money but the containers of the actual digital information that represents electronic money.

Finally, account-based electronic money products are certainly accepted as a means of payment by persons other than the issuer as a matter of recognised fact. It is believed that the policy considerations of the Treasury and the FSA as well as the interpretation of the definition of electronic money justify the conclusion that account-based electronic money products fall within the definition of e-money and ergo within the regulatory regime in respect of operators of such schemes in the United Kingdom. The fact that the monetary value in an account-based scheme can usually only be spent *with* the involvement of the operator is not considered a strong enough justification to exclude the schemes from the regime.

4. Authorisation and Exclusions

It is now established that an electronic money issuer that issues or wishes to issue electronic money by way of business in the United Kingdom, subject to some exceptions, must seek and obtain permission under Part IV of the [FSMA 2000](#) in order to do so lawfully. This is particularly true of ELMIs, which are e-money issuers that are not banks, building societies or incoming EEA or Treaty firms. Section 51(1) of the [FSMA 2000](#) provides that an application for Part IV permission must contain a statement of the regulated activity or activities in respect of which permission is sought and also give an address within the United Kingdom for service of necessary notices and documents. Further, under s. 51(3) an application for Part IV permission must be made in such manner as the FSA directs and contain or be accompanied by such information as the FSA may require.

The *Authorisation Manual* provides some amplification and guidance on the procedure for application for Part IV permission. In particular, applicants for permission are encouraged to contact the *FSA* before sending in their application and in complex cases to arrange a pre-application meeting for informal assistance; applicants must apply in writing in the manner directed, with the information required, and in the application pack provided by the *FSA*. The application pack requires a range of information from the applicant including, but not limited to, a business plan describing the regulated activities (and any unregulated activities that are not prohibited) proposed, management and organisational structure of the applicant, appropriately analysed financial and budget projections, and details of persons who will be running the proposed business.^{xxxii} The application, which should be accompanied by the application fee^{xxxiii}, must be given to a member of or addressed for the attention of the *FSA*’s Corporate Authorisation department

and delivered by post to or left at the given *FSA* address in London or hand delivered to a member of the *FSA*'s Corporate Authorisation department.^{xxxiv}

By s. 52 [FSMA 2000](#), the *FSA* is required to give a determination on the application before the end of six months beginning with the date on which it received the completed application. The determination of an uncompleted application, however, may occur up to twelve months beginning with the date the application was received. In accordance with s. 41(2) [FSMA 2000](#) the *FSA* is required, when giving or varying permission, to ensure that the applicant will satisfy and continue to satisfy the *threshold conditions*^{xxxv} (concerning legal status, location of offices etc) in relation to the regulated activities for which permission is sought. In the case of an ELMI this means that, among other things, the applicant must be a body corporate or a partnership. If it is constituted under the law of any part of the United Kingdom, its head office and also its registered office (if any) must be in the United Kingdom. On the other hand, if it is not a body corporate (i.e. a partnership) but has its head office in the United Kingdom it must carry on business in the country. In addition if the applicant has close links with another person^{xxxvi}, the *FSA* must be satisfied that those links are not likely to prevent the *FSA*'s effective supervision of the applicant. Finally, the *FSA* must be satisfied that the applicant has adequate resources in relation to the intended activity of issuing electronic money and that it is a fit and proper person to have Part IV permission.^{xxxvii} If an application is successful and the *FSA* gives Part IV permission, it must specify the permitted regulated activity which, as far as ELMIs are concerned, is issuing electronic money.^{xxxviii} When an ELMI is granted Part IV permission, it then becomes an authorised person for the purposes of the [FSMA 2000](#)^{xxxix}.

Apart from ELMIs, there are also specific provisions for authorisation concerning 'EEA firms' seeking to exercise what is known as 'passport rights', as well as 'Treaty firms' seeking to exercise 'Treaty rights', which wish to engage in issuing electronic money in the United Kingdom.^{xi} The definition of an 'EEA firm' encompasses a credit institution (including an electronic money institution) which does not have its head office in the United Kingdom but which is authorised by its home state regulator.^{xii} The 'passport right' (or *EEA right*)^{xlii} of an EEA firm refers to the entitlement of such a firm, with its head office in an EEA country other than the United Kingdom, to establish a branch in or to provide cross border services into the United Kingdom under a 'single market directive'.^{xliii} When an EEA firm exercises this right, the firm is referred to as an *incoming EEA firm*. A 'Treaty firm' on the other hand is one whose head office is in an EEA State (its home state), other than the United Kingdom, and which is recognised under the law of that State as its national.^{xliv} The exercise of 'Treaty rights' by such a firm, established outside the United Kingdom, refers to its entitlement to be authorised to carry on a regulated activity *not covered by a single market directive* in the United Kingdom.^{xlv} When a Treaty firm exercises this right it is called an *incoming Treaty firm*.

Schedules 3 & 4 of the [FSMA 2000](#) set out the requirements that must be fulfilled for an EEA firm or a Treaty firm, respectively, to qualify for authorisation. This is further to section 31 of the [FSMA 2000](#) which provides, among other things, that

an EEA firm qualifying for authorisation under schedule 3 and a Treaty firm qualifying for authorisation under Schedule 4 are authorised persons for the purposes of the Act. Under Paragraph 12 of Schedule 3, an EEA firm qualifies for authorisation under the Act when seeking *to establish a branch* in the United Kingdom if it satisfies the ‘establishment conditions’ (set out in Paragraph 13) including, among other things, that the *FSA* has received a ‘consent notice’ from the firm’s home regulator that it has given the firm consent to establish a branch in the United Kingdom. If the EEA firm merely seeks to provide services in the United Kingdom, without establishing a branch, then it qualifies for authorisation if it satisfies the ‘service conditions’ (set out in Paragraph 14) including, among other things, that the *FSA* has received a ‘regulator’s notice’ from the firm’s home state regulator or, if none is required, that the *FSA* has been given ‘notice of intention’ of the firm to provide services in the United Kingdom.

A departure from the normal requirements for authorisation concerns ‘small e-money issuers’. The issuing of electronic money by a firm which has been given a certificate by the *FSA* under Article 9C of the [Regulated Activities Order](#) (as amended) is not considered to be a regulated activity. Such a certificate may be granted to a body corporate or a partnership, other than a credit institution, which has its head office in the United Kingdom if at least one of three conditions is satisfied. The three stated conditions are: (1) that the firm only issues electronic money with a maximum storage of 150 euro on its electronic device, and the firm’s total liabilities with respect to issuing electronic money will not *usually*^{xlvi} exceed 5 million euro and will never exceed 6 million euro; (2) the firm’s total liabilities with respect to issuing electronic money will not exceed 10 million euro and the electronic money issued by the firm is accepted as a means of payment only by its subsidiaries which perform operational or ancillary functions related to electronic money issued by the firm or by other members of the same group as the firm not being its subsidiaries; (3) electronic money issued by the firm is accepted as a means of payment in the course of business by not more than one hundred persons all of whom are within the same premises or limited local area^{xlvii} or all of whom have a close financial or business relationship with the firm.^{xlviii} A small e-money issuer falling in the third category is also referred to sometimes as a ‘local e-money issuer’.

If an e-money issuer falls under any of the three categories of small e-money issuer, it may apply for a certificate under Article 9C of the [Regulated Activities Order](#) and, if the certificate is granted, the firm is referred to as a ‘certified person’^{xlix} and does not need to be *authorised* under the [FSMA 2000](#) in order to issue electronic money in the United Kingdom to that limited extent. Although a small e-money issuer to whom a certificate has been granted by the *FSA* is excluded from the requirement to be authorised, it is not an *exempt* person as defined in s. 417 [FSMA 2000](#)¹ and does not benefit from the exclusion in Article 16 of the *Financial Promotion Order*.^{li} An interesting note is that an *authorised* person can be granted a certificate as a small e-money issuer unless it is a full credit institution. Accordingly, a bank or building society may not apply for a small e-money issuer certificate and if such an institution wishes to carry on the regulated activity of issuing electronic money, it must actually apply for permission to do so.^{lii}

In summary, for an e-money issuer to carry on the regulated activity of issuing e-money lawfully in the United Kingdom it must be either an ELMI that is authorised by having obtained Part IV permission to do so, a bank or building society (or full credit institution) that is authorised by having obtained Part IV permission to do so, an EEA firm or Treaty firm that is authorised by qualifying for authorisation to do so under either Schedule 3 or 4 of the [FSMA 2000](#), or a small e-money issuer that has been granted a certificate by the FSA under Article 9C of the [Regulated Activities Order](#). The provisions of [ELM](#) concerning the prudential supervision of electronic money institutions apply, to varying degrees, to each of the categories of electronic money issuers and some of these are explored in the next section.

5. Prudential Supervision of Electronic Money Issuers

Section 2(2) as amplified by sections 3-6 of the [FSMA 2000](#) sets out the regulatory objectives of the Act as market confidence, public awareness, the protection of consumers, and the reduction of financial crimes. As far as electronic money issuers are concerned, detailed provisions for achieving these objectives are contained in Module [ELM](#) of the *Handbook of Rules and Guidance* which implements parts of the [Electronic Money Directive](#) and the Banking Consolidation Directive concerned with the regulated activity of issuing electronic money. The provisions of [ELM](#) cover a range of regulatory and supervisory matters including own funds and capital requirements, restrictions on the types of activities and investments that an e-money issuer can carry on lawfully, system controls including management, administrative and accounting procedures, protection of consumers including redemption of e-money, provision of information and purse limits. The following is a summary of some of the key provisions of [ELM](#).

5.1 Initial and Continuing Own Funds Requirements

The provisions concerning the initial and continuing own funds requirements of ELMIs are contained in § 2 of [ELM](#). These requirements do not apply in respect of incoming EEA or Treaty firms which would have qualified for authorisation under either Schedule 3 or 4 of the Act. They also do not apply to an ELMI that is a lead regulated firm^{liii} and, as the definition of ELMI excludes banks and building societies, neither do they apply to those institutions whose capital requirements are set under [Directive 2000/12/EC](#). Outside these categories, an ELMI is required^{liv} to have initial capital, calculated in accordance with § 2.4.2 [R] [ELM](#), amounting to not less than one million euro or its equivalent.^{lv} In addition, there is an ongoing requirement that an ELMI must, at all times, maintain own funds that are, at any time, equal to or higher than 2% of its total financial liabilities for e-money at that time or the average of its daily financial liabilities for e-money in the immediately preceding six month period.^{lvi}

§ 2.2.3 [G] [ELM](#) explains that the purpose of the capital requirements is to help an ELMI to maintain itself as a viable going concern, and to overcome expected and unexpected difficulties and to sustain its infrastructure; help an ELMI to secure its

ability to redeem e-money whenever redemption may be required; and, help to maintain public confidence in an ELMI's ability to redeem e-money as and when required.

5.2 Limitations on Investments of ELMIs

The provisions concerning the limitation of the types of investment that an ELMI can engage in and the management of its e-money float, contained in § 3 [ELM](#), also, do not apply to banks and building societies, lead regulated firms and incoming EEA or Treaty firms. In general, ELMIs to which the provisions apply are limited to making only low risk and high liquidity investments in order to ensure the stability of such institutions and the electronic money sector generally as well as to protect consumers.^{lvii} § 3.3.1 [R] [ELM](#) provides that an ELMI must, at all times, have qualifying liquid assets of a value not less than the amount of its total financial liabilities for e-money at that time. A qualifying liquid asset is defined in § 3.3.5 [R] [ELM](#) as an investment that: (1) is unsubordinated; (2) ranks at least equally with the unsubordinated, non-preferred and unsecured obligations of the person who owes the obligation; (3) is zero weighted or a deposit that is repayable on demand and is held with a Zone A credit institution^{lviii} or a qualifying debt security; and, (4) it has a residual maturity of one year or less or if an investment on which a floating rate of interest is payable, the interest will be re-determined no less than one year from the time in question.^{lix} An ELMI is also required, by § 3.6.1 [R] [ELM](#), to maintain adequate liquidity, taking into account the nature and scale of its business, in order to meet its obligations as they fall due.

In addition, limits are also set on the amount of large exposure that an ELMI may have. In the first place, an ELMI is required under § 3.3.13 [R] [ELM](#) to choose which particular qualifying liquid assets to treat, consistently for the purposes of [ELM](#), as its e-money float, being the qualifying liquid assets that it does not need in order to satisfy the foregoing requirements of § 3.3.1 [R] [ELM](#). It is then provided in § 3.5 [ELM](#) that an ELMI must not at any time have any, single, large e-money float exposure that exceeds 25% of its own funds and that the total of its large e-money float exposures must not at any time exceed 800% of its own funds. Finally, in order to ensure that the e-money float of an ELMI is not put at risk by foreign exchange exposures, it is also provided that an ELMI must, at all times, have sufficient funds to ensure that its foreign exchange exposure does not exceed its absolute foreign exchange exposure limit.^{lx}

Apart from the foregoing provisions limiting the type of investments that an ELMI may make, an ELMI is also prohibited under § 3.7 [ELM](#) from engaging in derivative or quasi-derivative contracts save for listed exceptional circumstances. An ELMI may only be a party to a derivative or quasi derivative contract if: the sole purpose is to hedge market risks arising from issuing e-money or from the e-money float and so, far as reasonably possible, being a party to such a contract achieves that purpose; the derivative or quasi-derivative is sufficiently liquid and is either an exchange rate contract relating to a foreign currency with an original maturity of 14 days or less, or is an interest rate or foreign exchange related

contract, or is regularly traded on a recognised or designated exchange, or is subject to daily margin requirements under the rules of that exchange.

5.3 Restrictions on Business Activities of ELMIs

Although the regulatory regime of the [Electronic Money Directive](#) implemented in the United Kingdom in respect of ELMIs is less cumbersome and less stringent than the regulation of full credit institutions, a corollary objective of the regime is to preserve a level playing field between ELMIs and other credit institutions.^{lxi} One of the ways of achieving this objective is the placing of restrictions on the business activities which ELMIs may carry on. Accordingly, [ELM](#) contains provisions restricting the business activities of ELMIs to a specified range. These restrictive provisions are contained in chapter 4 of [ELM](#).

According to chapter 4 of [ELM](#), the business activities that ELMIs may carry on are restricted to, primarily, issuing e-money. Secondly, an ELMI may provide financial and non-financial services closely related to issuing e-money such as administering e-money through related operational and other ancillary functions and issuing and administering other means of payment. An ELMI may also store, on behalf of other undertakings or public institutions, data on electronic money devices on which e-money issued by the ELMI is stored. An ELMI is expressly prohibited from granting any credit in the course of or for the purpose of issuing e-money although the receipt of a cheque by an ELMI for e-money issued by it is not considered as granting credit. In addition, an ELMI must not pay interest or any similar sum on e-money issued by it and neither it nor any member of its sub group is allowed to have an ownership share in another undertaking except an undertaking whose only activity is the performance of operational or other ancillary functions related to e-money issued or distributed by that ELMI.

These restrictions do not apply in respect of banks and building societies that are also e-money firms. Neither do they apply in respect of incoming EEA or Treaty firms. They apply, however, to ELMIs that have their registered or head office in a country outside the United Kingdom.^{lxii} In respect of the ELMIs to which they do apply, it is stated in § 4.1.3. [ELM](#) that they apply on a worldwide basis. This means that such an ELMI cannot carry on any of those prohibited activities anywhere in the world. It may be that this point raises conceptual issues of extra-territoriality of domestic legislation, especially in relation to non-EEA overseas ELMIs but the critical point is that violation of the prohibition will result in contravention of the regulatory regime in the United Kingdom.

Another restriction on the business activities of ELMIs is the prohibition of the issuing of e-money at a discount. § 4.4.1 [R] [ELM](#) provides that an ELMI must not issue e-money that has a greater monetary value than its e-money issue price. One of the reasons for this restriction, as explained in § 4.2.3 [G] [ELM](#) is to prevent the creation of monetary value in an uncontrolled way. Importantly, this particular restriction also applies to banks and building societies but not to incoming EEA or Treaty firms. They also apply in respect of non-EEA overseas ELMIs, that is, ELMIs with its registered or head office outside the United Kingdom and the EEA but this time only in relation to e-money issued by such an

ELMI from an establishment in the United Kingdom. This means that a non-EEA ELMI, with an establishment in the United Kingdom, may issue electronic money at a discount through an establishment in a country outside the United Kingdom and the EEA provided, presumably, that there is no prohibition on issuing electronic money at a discount in that other country. On the other hand, as the definition of electronic money in Article 3 of the [Electronic Money Directive](#) includes a condition that the e-money is “issued on receipt of funds of an amount no less than the monetary value issued”, it would seem that the prohibition would include issuing e-money at a discount in a member State of the European Union.^{lxiii}

5.4 Management and Systems Controls

An ELMI, excluding a bank or building society and an incoming EEA or Treaty firm, is required to ensure that at least two individuals effectively direct its business. This is sometimes referred to as the ‘four eyes requirement’ and is spelled out in § 5.3.1. [R] of [ELM](#).^{lxiv} This is amplified in § 5.3.5. G of [ELM](#) which states that both individuals are expected to play a part in the decision-making process on all significant decisions otherwise it may be considered that only one of them is *effectively* directing the business of the ELMI. It is further explained that although both need not be involved in the day-to-day execution and implementation of policy, both should demonstrate the qualities and application to influence strategy, day-to-day policy and their implementation. With regard to an overseas firm, the assessment is based on whether two individuals effectively direct the business of the whole firm and not just the business of the branch or branches of the firm in the United Kingdom.

An ELMI is also required to take reasonable care to establish and maintain such systems and controls as are appropriate to its business.^{lxv} This includes, for example, ensuring that there are clear management responsibilities and reporting lines communicated appropriately within the firm, ensuring the due diligence and suitability of persons to whom it out-sources any function or task other than its regulatory obligations which cannot be contracted out, and authenticating its transactions and the identity of its customers.

5.5 Information, Purse Limits and Redemption of E-Money

In order to protect consumers and to enhance consumer confidence in e-money, [ELM](#) contains provisions that require e-money firms to provide certain information to holders of its e-money, observe set purse limits in respect of e-money issued, and to allow holders of its e-money the right to redeem^{lxvi} e-money in stated circumstances. These provisions are contained in chapter 6 of [ELM](#) which applies in relation to e-money issued from an establishment maintained in the United Kingdom. The provisions thus apply in respect of all e-money firms including banks and building societies and even to EEA and Treaty firms in respect of e-money issued by them from an establishment maintained in the United Kingdom. The only circumstance in respect of which the provisions do not apply is in relation to EEA or Treaty firms carrying on business in the United Kingdom *on a cross-border services basis only*.^{lxvii}

An e-money firm is obliged, before issuing e-money to any person, to supply that person with information about the amount of any permitted fee^{lxxviii} in connection with the redemption of e-money issued by it or the fact of no redemption fee if that is the case, details of how to redeem e-money issued by the firm to that person, the permitted minimum amount of e-money that can be redeemed, and the length of period for which e-money issued by the firm is valid. In addition, an e-money firm must supply actual and prospective holders of e-money issued by it, or that may be issued by it in future, information about: the redemption right, an explanation of the liability of the holder of such e-money for loss arising from fraud or the conduct of another person in relation to that holder's e-money, loss, malfunction or theft of that holder's electronic money device and any other significant risks in connection with the holding of the e-money. An e-money firm must also notify an actual or prospective holder of its e-money that the *Financial Services Compensation Scheme*^{lxxix} does not cover claims in connection with issuing e-money and, however, of any other complaints and redress procedures available to the holder, including the *Financial Ombudsman Service*^{lxxx} and details of any scheme that compensates holders in respect of e-money issued by the firm, or the absence thereof, where it is unable to satisfy claims. Finally, an e-money firm must also provide the holder with information about how the holder may initiate the available complaints and redress procedures as well as a geographical address at which the firm may be contacted.^{lxxxi}

The purse limit for e-money issued by an e-money firm to a *consumer e-money holder*, that is, a person who holds that e-money other than in the course of a business or profession, is set at £1000 or its equivalent in another currency in which the e-money is denominated.^{lxxii} Theoretically, therefore, an e-money firm can issue e-money above the £1000 purse limit to a non-consumer e-money holder. In particular circumstances, exceptionally, an e-money firm may issue e-money exceeding the £1000 purse limit to even a consumer e-money holder. The circumstances are that the firm: has first given the consumer e-money holder a warning^{lxxiii} in writing,^{lxxiv} presented in a manner that can be easily understood and which is best calculated to bring it to the attention of that holder to allow him to consider it; and, has received an acknowledgement relating to that particular warning only, in writing, from the holder that he understands the warning and accepts the risks. Moreover, despite the warning and its acknowledgement by the holder, an e-money firm is only allowed to issue e-money exceeding the £1000 purse limit in those circumstances if three additional requirements are met. These are that the scheme under which the e-money is issued is organised such that loss, theft or malfunction of the *consumer e-money device* will not result in the loss by the holder of his e-money and will not prejudice his redemption right substantially; the e-money firm is able to prevent the use or spending of the e-money it issued under the relevant scheme; and, the identity of the holder, the amount of e-money to which he is entitled and the identity of the person who has a redemption right are determined by records maintained by or on behalf of the e-money firm.^{lxxv}

The foregoing provisions relate especially to e-money issued in circumstances where the e-money issuer maintains a record of the owners of the e-money that it

issues. In particular, in a case where the e-money is issued on a consumer e-money device, which is a device intended to be used by and in presence of the consumer e-money holder (sometimes referred to as identified e-money), the maintenance of records by the e-money firm should mean that theft or loss of the device pose a limited risk to the holder. On the other hand, where e-money is stored on a *consumer e-money card*, especially if the scheme is such that the card may be used without requiring proof of identity of the true holder (sometimes referred to as 'anonymous e-money'), the loss or theft of the card may result in the holder losing the e-money stored on it.^{lxxvi} In connection with this, § 6.9.12 [R] of *ELM* also provides that an e-money firm must ensure that information about a geographical address at which it may be contacted and a brief summary of the risks relating to loss or theft are physically printed on a *consumer e-money card* or the packaging in which it is made available to the public.

The duty of an e-money firm to redeem e-money issued by it and the redemption right of a holder are set out in detail in chapter 6 of *ELM*. § 6.3.1 [R] of *ELM* provides that an e-money firm must, upon request from the person to whom it issued the e-money or from any person whose holding of the e-money is not contrary to its e-money scheme rules (e.g. a merchant who had accepted payment via the firm's e-money), redeem at par any e-money that it has issued. The person exercising this redemption right is entitled to have the proceeds of redemption paid in the currency in which the e-money is denominated;^{lxxvii} in cash following the completion, as soon as reasonably possible, of checks to prevent money laundering^{lxxviii} or fraud;^{lxxix} by electronic transfer to an account with a bank or other financial undertaking in which case the payment instructions must be given following the completion, as soon as reasonably possible, of checks to prevent money laundering or fraud and ensuring that payment must reach the holder's account within five business days of giving the payment instructions.^{lxxx} In the latter case, if the failure of the funds to reach the holder's account is due to a failure outside the e-money firm's control, the firm is not in breach of the provisions.^{lxxxi}

The right of a holder to redeem e-money is limited, however, to e-money that has a par value of not less than 10 euro or its equivalent in the currency of denomination of the e-money and if this is expressly provided for in the e-money scheme rules.^{lxxxii} With regard to the length of time of validity of e-money, it is provided that a firm must not issue e-money that is valid for less than a year and, where the e-money is *distributed* to the public by banks or other distributors to whom it has been issued by an e-money firm, the firm must use reasonable endeavours to ensure that it remains valid for at least a year after its distribution to the public. Crucially, if the e-money scheme rules state that e-money ceases to be valid after a specified period, a holder who had not redeemed his e-money by that period loses his right to redeem the e-money.^{lxxxiii}

6. Protection of Consumers: E-Money compared to Credit and Debit Cards

At present payment for most transactions, especially consumer transactions over the World Wide Web, is carried out by means of a credit card. There had been, and still remain, some security concerns on the part of consumers especially about transmitting their credit card details online with the risk of the details being intercepted by or otherwise becoming available to unauthorised third parties. The development of encryption protocols/standards for online payment (e.g. SSL – Secure Sockets Layer; and SET – Secure Electronic Transaction) has provided greater assurance and encouraged payment online by means of credit cards. The general law relating to credit card transactions apply in relation to card payments for e-commerce transactions as well.^{lxxxiv}

From an e-commerce, as well as the general, perspective a number of issues arise in relation to payment by credit cards. Firstly, if a consumer pays in advance for goods by credit card but the goods never arrive or he is dissatisfied with the goods when they arrive, what are his options at law? In the first case he might have a contractual claim against the supplier under the supply contract. He may need to consider alternative possibilities, however, if a claim against that supplier is pointless or onerous e.g. the supplier's exact details and location are difficult to establish, the supplier is located in a far off jurisdiction, or the supplier has become insolvent. In that case the purchaser may seek to pursue the remedy of preventing his card account from being debited by the card issuer (bank or other institution).

In the United Kingdom, if the purchaser were a consumer, a very likely alternative source of redress in that manner would be the *Consumer Credit Act 1974 (CCA)*. The act refers to 'credit tokens' but it is generally taken that credit cards come within the definition of credit tokens in its s.14. Section 75(1) of the CCA provides that if a debtor under an agreement regulated by the Act (effectively a consumer holding a credit card) 'has, in relation to a transaction financed by the agreement, any claim against the supplier in respect of a misrepresentation or breach of contract, he shall have a like claim against the creditor [card issuer] who, with the supplier shall be jointly and severally liable to the debtor.'

This means that if the consumer who made payment with a credit card could claim against the supplier on the basis of *misrepresentation* or *breach of contract*, he could make a similar claim against the card issuer. Thus if the supplier is untraceable or suing the supplier is too onerous, say he is in a distant jurisdiction, the consumer may simply seek redress against the card issuer. This may be either in terms of preventing the card issuer from debiting his card account for the amount concerned or seeking a refund of that amount from the card issuer – provided that that the payment concerned must be no less than £100 and no greater than £30,000; s. 75(3). Section 75 also requires that the payment by credit card should have been made under pre-existing arrangements, or in contemplation of future arrangements, between the card issuer and the supplier/merchant.

In a different scenario the consumer's credit card may have been used fraudulently by a thief or opportunist, say by someone who intercepts his details over the World Wide Web or by the operators of a fraudulent website set up

simply to obtain credit card details of unsuspecting bargain hunters. If the credit card holder is a consumer he may also be able to get some protection under the CCA. Section 83 CCA provides in effect that a debtor under an agreement regulated by the Act (effectively a consumer holding a credit card) is not liable to the creditor (card issuer) for any loss arising from the use of the [credit card] by another person not acting, or not to be treated as acting, as the debtor's agent. The provision in effect establishes a general rule that a credit card holder is not liable to the card issuer for any loss resulting from unauthorised use of the card. This is, however, a general rule that is qualified by other provisions. In the first place if the person who misused the card had obtained possession of it with the cardholder's consent, the cardholder may be liable 'to any extent' in respect of losses caused by such misuse {s. 84(2) CCA}. On the other hand, if the card is accidentally lost or stolen the debtor/cardholder may be liable up to a maximum of £50 while the card is in the possession of an unauthorised person. The debtor/cardholder is not liable for any loss that arises after the creditor/card-issuer has been given oral or written notice that the card is lost, stolen or otherwise liable to misuse; s. 84(1) CCA.

It is difficult to see how a *consumer e-money device* or even a *consumer e-money card* could be brought within the purview of the Consumer Credit Act to enjoy the forgoing consumer protection provisions afforded by the Act. By the terms of s. 14 of the Act, it is concerned with *credit* tokens given by a person carrying on consumer *credit* transactions. The definition of electronic money on the other hand includes the element that it is *issued on the receipt of funds*. Thus, although e-money firms are now regarded as credit institutions, the issuing of e-money is not a credit agreement. There is even some amount of doubt as to whether debit cards are covered by the protection afforded by the CCA, in particular whether they fall within the definition of 'credit token' or are issued under a credit token agreement as defined in s.14 of that Act.^{lxxxv} There may, however, be an element of credit to a debit card where the cardholder is granted an overdraft facility.

There is, nevertheless, another possible source of protection for the consumer cardholder which extends to a debit card holder^{lxxxvi} and which may extend, potentially, to a holder of a consumer e-money card and even possibly to a holder of a consumer e-money device. This is to be found in Regulation 21 of the [Consumer Protection \(Distance Selling\) Regulations 2000](#) (SI 2000/2334) the relevant provisions here of which apply only in relation to an agreement to which s. 83 CCA does not apply. In addition s. 84 CCA is amended as explained below.

By Regulation 21(1) & (2), a consumer is entitled to cancel a payment where fraudulent use has been made of his payment card in connection with a 'distance contract'^{lxxxvii} by another person not acting, or not to be treated as acting, as his agent; if such fraudulent use is made of his payment card, the consumer is entitled to be re-credited or to have all sums returned by the card issuer. The burden of proving authorised use is on the card issuer according to Regulation 21(3).

Regulation 21(5) amends s. 84 CCA to the effect that *with regard to distance contracts* (other than excepted contracts) a consumer cannot be held liable for *any* unauthorised use of his payment card. In effect, this means that in relation to

relevant distance contracts a consumer is not liable for the first £50 pounds that he could have been liable for under s. 84 (1) CCA and neither is he liable under s. 84 (2) CCA even if he fails to report loss, theft or that the card is otherwise liable to misuse. Thus if a consumer's credit or debit card is used fraudulently or without authorisation to purchase goods, for example on the World Wide Web (most likely a distance contract), the consumer is entitled not to reimburse his card-issuer or to be re-credited. In turn the card-issuer will normally pursue the supplier or, if the supplier is untraceable, bear the loss which is likely to be covered by insurance in any event.

The question now is whether the protection afforded in relation to 'payment cards' in the [Distance Selling Regulations 2000](#) also extends to consumer e-money devices and consumer e-money cards – as far as distance contracts are concerned. Regulation 21(6) provides that 'payment card' *includes* credit cards, charge cards, debit cards and store cards. It is not utterly inconceivable that consumer e-money devices and consumer e-money cards may be held to fall within this definition which is in-exhaustive in light of the word 'includes'. There are some reasons to support the inclusion of at least consumer e-money cards within the definition. In the first place, as the definition of payment card is not exhaustive it follows that the categories of payment card are not yet closed and an e-money card is certainly contemplated for use as a payment card.^{lxxxviii} Secondly, if some of the objectives of the electronic money regulatory regime are to enhance consumer confidence and to promote the use of e-money, an added layer of consumer protection can only help in that direction.

A related development which deserves at least a cautious welcome is that the *Banking Code* (banks' *voluntary* code of practice) offers some amount of consumer protection in relation to an 'electronic purse'. In the latest edition (March 2003) of the Code, banks undertake in § 9.15 to take immediate steps to try to prevent an electronic purse, among other things, from being used once told that it has been lost or stolen. §12.12 of the Code provides, however, that if the electronic purse is stolen or lost its holder thereby loses any money in it just as if he lost his wallet. Nevertheless, some further protection is given in relation to loss, theft or misuse of an electronic purse. §12.13 of the Code provides that if money is transferred from a customer's account *to* his electronic purse before he reports its loss, theft or misuse, the customer's liability is limited to £50. If money is transferred from the customer's account *to* the electronic purse after he reports its loss, theft or vulnerability of his PIN the customer will not lose any money at all. In its own way the protection afforded by the banking code is valuable. At least the amount that the holder of an electronic purse could lose in the event of its theft or loss is finite and, in the end, restricted to a maximum of the amount of value left on the card at the time of its loss or theft plus £50 if money is transferred onto the purse before its loss or theft is reported. The drawback of course is that in light of §12.12 of the Code the customer does lose any money left on the card.

In relation to the Banking Code, one final matter that needs to be resolved for the purposes of this article is whether the protection afforded by the *Banking Code* in respect of an 'electronic purse' also extends to a *consumer e-money device* or a

consumer e-money card. The Code defines an electronic purse in the following terms: 'any card, or function of a card, which contains real value in the form of electronic money which someone has paid for beforehand. Some cards can be reloaded with more money and can be used for a range of purposes.' It may be that as the code is not exactly a legislative instrument, a more relaxed approach may be taken towards its interpretation. As things stand, however, the definition of electronic purse would seem to exclude an e-money device that is not based on a card especially as the Code's definition of a card contemplates a *plastic card* unless the phrase 'function of a card' is stretched. A consumer e-money card is more likely to come within the definition of electronic purse but, in view of the link between an electronic purse and an 'account'^{lxxxix} however, it would probably have to have been issued or at least distributed by a bank.

7. Electronic Money Perimeter Guidance: FSA Consultation Paper 172

Appendix 3 to the Authorisation Manual contains guidance on the scope of the regulated activity of issuing e-money to assist persons who need to know whether a particular electronic payment product is e-money and whether such product falls within the regulatory regime. In February 2003, the FSA issued a consultation paper about the perimeter guidance on electronic money with a view towards additional provisions concerning some seemingly grey areas. In particular consideration is the position concerning prepaid airtime on mobile phones to buy premium rate services, such as ring-tones for example which may be from third parties, electronic travellers' cheques and e-money backed by funds held in trust accounts.

In summary, the tentative position of the FSA is that, firstly, pre-paid airtime simply used to call premium rate services in circumstances where the supply of airtime and the supply of the premium rate service can be seen as a single service, especially where the supply of the premium rate service occurs in the same action as the supply of airtime, does not amount to e-money; on the other hand, if prepaid airtime is used to acquire goods or services that are consumed by means other than the mobile phone, such as physical delivery of goods, the prepaid airtime would be considered as electronic money. Secondly, the FSA considers that electronic travellers' cheques, being smart cards that carry a prepaid balance and that can be used to withdraw money from ATMs, do not constitute e-money but will do so if they can also be used to withdraw cash from third parties' ATMs or to buy goods and services from third parties. Finally, the FSA considers that e-money schemes where the float moneys received against the issue of e-money are allowed to be invested in a trust account remain within the definition of e-money and are compatible with the regulatory regime. At the end of the consultation and response period, the FSA is expected to publish an updated version of the perimeter guidance on the issuing of electronic money.

8. Concluding Comments

The implementation of the [Electronic Money Directive](#) in the United Kingdom and the attendant regulatory regime that has been set in place for e-money firms is overall a positive development. The knowledge, by potential e-money product

consumers, that there is a regulatory framework within which e-money firms operate with inbuilt consumer protection provisions may serve to encourage future uptake of e-money products. A drawback however would be that potentially there is greater protection for a person whose credit card is lost, stolen or misused than for a holder of an electronic money device in similar circumstances. This might be a matter for further consideration by the legislative and regulatory authorities. The setting of the purse limit for e-money at £1000, subject to the permitted exceptions, may go some way to alleviate consumers concerns about their potential risks.

A parallel could actually be drawn with some electronic payment services, as opposed to e-money proper, such as services provided by companies like [Paypal](#) and [Nochex](#) which allow one party to transmit money to another with knowledge only of the other party's e-mail address. The service provider debits the payer's bank or credit card account, registered with itself, with the amount to be paid to the other party plus any charges and transmits that amount less any charges to the bank or credit account, also registered with it, of the other party. The attraction for customers of this type of service is that its account can only be debited by a trusted company, a trusted third party, and only in respect of amounts authorised by the customer. By all indications, it seems that this sense of security and capping of potential liability are attracting customers to this type of service which is used increasingly for online transactions and this simplified version^{xc} of an electronic money service may prove a strong rival to e-money proper despite the setting of purse limits for e-money at £1000. A further parallel may also be drawn with traditional money transfer services such as that offered by Western Union which, normally, do not involve the *storage* of monetary value and, thus limited, would seem to fall outside the regulatory regime of electronic money. Ultimately, consumer confidence will be a key factor in any future success of the hitherto struggling e-money sector.

Notes and References

ⁱ. For an extensive list and overview of some of the different extant schemes, see <http://www.w3.org/ECommerce/roadmap.html>.

ⁱⁱ. There other forms of transmitting electronic money online, especially via e-mail, that do not necessarily involve unit storing devices but by which the service provider transmits money from one party's bank or credit card account to another's account and notifying the respective parties by e-mail. See further footnote 90 below and accompanying text.

ⁱⁱⁱ. For further description/explanation of the various possibilities, see M.A. Froomkin, 'Flood Control on the Information Ocean: Living With Anonymity, Digital Cash, and Distributed Databases,' (1996) 15 U. Pittsburgh Journal of Law and Commerce 395 available online at <http://www.law.miami.edu/~froomkin/articles/ocean.htm>; see also

<http://www.ex.ac.uk/~RDavies/arian/emoney.html>.

iv. See e.g. W.R.M. Long & J.M. Casanova, 'European Initiatives for Online Financial Services, Part 1: The Regulation of Electronic Money' (2002) 6 JIBFL 242.

v. 'Electronic money institution' is defined in Art. 1.3. of Directive 2000/46/EC to "mean 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".

vi. SI 2001/544

vii. Art 2 of SI 2002/682 inserts this definition of 'electronic money' into Art 3(1) of the earlier SI 2001/544

viii. W.R.M. Long & J.M. Casanova, 'European Initiatives for Online Financial Services, Part 2: Financial Services and the Regulation of Electronic Money' (2003) JIBFL 8 at 11.

ix. See Art. 1(3) of Directive 2000/46/EC.

x. See s. 3.2.9 [G] & 3.2.10 [G] of *Appendix 3* to the *Authorisation Manual*

xi. Inserted by Article 4 of SI 2002/682.

xii. Inserted by Article 6 of SI 2002/682.

xiii. As amended by Article 5 of SI 2002/682.

xiv. Inserted by Article 3 of SI 2002/682.

xv. See Art. 1(4) of Directive 2000/46/EC.

xvi. The amendment was introduced by Art 8 of SI 2002/682.

xvii. For definitions of various types of electronic money issuers, see the [Glossary of Definitions](#) section of the *Handbook of Rules and Guidance*.

xviii. A 'lead regulated firm' is defined in the [Glossary of Definitions](#) as 'a firm which is the subject of the financial supervision requirements of an overseas regulator in accordance with an agreement between the FSA and that regulator relating to the financial supervisions of firms whose head office is within the country of that regulator'.

xix. See further section 4 below.

xx. An incoming EEA firm is an EEA firm which is exercising or has exercised its right to carry on a regulated activity in the United Kingdom in accordance with Schedule 3 to the FSA (EEA "passport rights") while an incoming Treaty firm is a Treaty firm that is exercising or has exercised its right to carry on a regulated activity in the United Kingdom in accordance with Schedule 4 to the FSA (Treaty rights).

xxi. See further section 5 below.

xxii. See §1.1.3 [R] & 1.3.2. [G] *ELM*.

xxiii. The Financial Services and Markets 2000 (Carrying on Regulated Activities by Way of Business) Order 2001.

^{xxiv}. *Appendix 3 - Guidance on the Scope of the Regulated activity of Issuing E-Money*. The *Guidance* is however not binding on the courts although it could be of persuasive effect when considering whether it would be just and equitable to allow a contract to be enforced. See § 3.1.5 [G] of *Appendix 3*.

^{xxv}. *AUTH* § 2.3.2. [G] (4)

^{xxvi}. *AUTH* § 2.3.3. [G]

^{xxvii}. See §. 3.2.12-3.2.14 [G] of *AUTH Appendix 3*

^{xxviii}. Discussed further in section 4 below.

^{xxix}. Inserted by Article 3 of SI 2002/682.

^{xxx}. S. 419 FSMA originally listed four circumstances but a fifth was added by Regulation 13 of the *Electronic Commerce Directive (Financial Services and Markets) Regulations 2002* (SI 2002/1775).

^{xxxi}. Under s. 418 of the FSMA the circumstances in which a person who is carrying on regulated activity but who would not normally be regarded as carrying it on in the United Kingdom is regarded as so carrying it on for the purposes of the Act include the following: a) where the person's registered or head office is in the United Kingdom or he is entitled to exercise rights under a Single Market Directive and he carries on a regulated activity in *another* EEA State; b) where the person's registered or head office is in the United Kingdom and the day to day management of the activity is the responsibility of that registered/head office or of another establishment maintained by the person in the United Kingdom; c) where the person's head office is not in the United Kingdom but the activity is carried on from an establishment maintained by the person in the United Kingdom; d) where a person carries on an electronic commerce activity (provision of an information society service) in another EEA State but from an establishment in the United Kingdom.

^{xxxii}. Persons who will be running the business in capacities such as 'controllers', directors, partners and members of the governing body will be performing 'controlled functions'. They will be assessed by the FSA to determine whether they are fit and proper persons either to have control or to be granted approval as 'approved persons'. See §. 3.9.24 [G] & chapter 6 of the *Authorisation Manual*, and Modules *FIT* and *APER* of the *Handbook of Rules and Guidance*.

^{xxxiii}. See Chapter 4 of the *Authorisation Manual*.

^{xxxiv}. See generally, § 3.9 of the *Authorisation Manual*.

^{xxxv}. See Schedule 6 of the FSMA and Module *COND* of the *Handbook of Rules and Guidance*.

^{xxxvi}. 'Close links' refers to the relationship between parents, subsidiaries companies and members of a group of companies. See Schedule 6 Paragraph and Directive No.95/26/EC of 29 June 1995. Additionally, there are provisions in chapter 7 *ELM* addressing other regulatory concerns arising from group membership but those are not considered further here.

^{xxxvii}. The requirement that the applicant should be a 'fit and proper' person (the suitability condition) applies in relation to the firm itself. It is separate from the provisions concerning persons who perform controlled functions (discussed earlier) although doubts over the individual or collective suitability of persons connected with the firm may lead the FSA to consider that the firm does not meet the suitability condition. See further § 2.5 *COND* and also the *Principles for Businesses (PRIN)* Module of the *Handbook of Rules and Guidance*.

^{xxxviii}. See s. 42(1) & (6) of the FSMA 2000.

^{xxxix}. See s. 31 FSMA 2000.

^{xl}. As far as ELMIs with a head office outside the United Kingdom but which are not EEA or Treaty firms are concerned, the normal procedures for granting Part IV permission to ELMIs apply although the FSA will take account of the extent to which such an ELMI is regulated in its home state. For these purposes the FSA would liaise with such an ELMI's home state regulator 'and would take into account information from it with respect to, for example, the adequacy of the applicant's resources and the applicant's suitability, having regard to the need to ensure that the applicant's affairs are conducted soundly and prudently.' See further S. 3.18 of the *Authorisation Manual*.

^{xli}. See Paragraph 5 of Schedule 3 to the FSMA 2000.

^{xlii}. See Paragraph 7 of Schedule 3 to the FSMA 2000.

^{xliii}. The relevant single market directives are set out in Paragraphs 1 & 2 of Schedule 3 to the FSMA 2000 and include: the first banking co-ordination directive; the second banking co-ordination directive; the insurance directives; and the investment services directive.

^{xliv}. See Paragraph 1 of Schedule 4 to the FSMA 2000.

^{xlv}. See Paragraphs 2 & 3 of Schedule 4 to the FSMA 2000.

^{xlvi}. Chapter 8 of *ELM* gives some guidance on the meaning of "usually" which is not itself defined and states that the application of the condition will depend on the facts of each case. § 8.4.7. and 8.4.8 [G] of *ELM* state that if a scheme exceeds the limit no longer than 5 days a month and 20 days a year it will not necessarily breach the condition but exceeding those ranges may call into question whether the condition is being met and, accordingly, the FSA will require a 'change report' if the total liabilities of the scheme with respect to issuing e-money exceeds 5 million euro.

^{xlvii}. Under Article 9C of the Regulated Activities Order, locations are to be treated as situated within the same premises or limited local area if 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 within an area which does not exceed four square kilometres. See further, § 8.4.10 [G] to 8.4.16 [G] of *ELM*.

^{xlviii}. For this condition, § 8.4.18 [G] of *ELM* provides guidance that that mere participation in arrangements for the acceptance of e-money issued by a small e-money issuer does not make a person to be treated as having a close financial or business relationship with the small e-money issuer.

^{xlix}. By Article 9I of the Regulated Activities Order, it is an offence under s. 24 FSMA for a person who is not a certify person to describe or hold himself out as a certified person.

^l. Under s. 417 FSMA, an *exempt* person is one exempt from the general prohibition of s.19 in relation to a particular regulated activity as a result of an exemption order made under s. 38(1) or as a result of s. 39(1) or s. 285(2) or (3) FSMA 2000.

^{li}. *Financial Services and Markets Act 2000 (Financial Promotion) Order 2001* (SI2001/1335).

^{lii}. See Articles 8.3.2. [G] and 8.4.2. [G] of *ELM*.

^{liii}. See footnote 18 above.

^{liv} See § 2.3.1 [R] of *ELM*.

^{lv}. Threshold condition 4 in Schedule 6 to the FSMA 2000 and § 2.4.1 *COND* provide that the resources of an ELMI must, in the opinion of the *FSA*, be adequate in relation to the regulated activity.

^{lvi}. See generally § 2.5 of *ELM*. If the firm has not been an ELMI for up to six months, the averaging of its daily financial liabilities for a six month period shall be based on the projected amounts of its daily e-money financial liabilities for the six month period beginning from the day it is granted permission to carry on the regulated activity of issuing e-money.

^{lvii}. See § 3.2 *ELM* and Long & Casanova, above note 8, at 9-10.

^{lviii}. A Zone A credit institution is defined in the Glossary as a full BCD credit institution under Directive 2000/12/EC or a credit institution that has its registered or head office in any EEA State or any other country which is a full member of the OECD or which has concluded special lending arrangements with the IMF associated with the IMF's General Arrangements to Borrow.

^{lix}. See further § 3.3.5 [R] to 3.3.10 [R] of *ELM*.

^{lx}. On the definition of an ELMI's foreign exposure limit and its absolute foreign exposure limit, see § 3.4.6 [R] and 3.4.7. [R] of *ELM*.

^{lxi}. See for example Preambles 11 and 12 of the *Electronic Money Directive*.

^{lxii}. See generally § 4.3. *ELM* and also Article 1(5) of the *Electronic Money Directive*.

^{lxiii}. The argument could have been made that in light of the definition of e-money, issuing e-money at a discount by an establishment *anywhere* is prohibited but for the express permissive exclusion contained in § 4.1.2 [G] *ELM*.

^{lxiv}. This requirement also helps to ensure or establish that an ELMI is in compliance with the provisions of § 3 *PRIN* and the *threshold condition* concerning suitability on which see *supra* notes 32 & 37.

^{lxv}. See generally § 3 of Module *SYSC* of the *Handbook of Rules and Guidance*.

^{lxvi}. The right to redeem must be expressed as a contractual term. For this purpose, the e-money firm must ensure that there is a contract between itself and any person to whom it issues e-money or any person with a redemption right (such as a merchant accepting its e-money as payment), in the case of the former, before it issues the e-money and in the latter before the person with the redemption right obtains the e-money or as soon as reasonably possible afterwards. See § 6.7 *ELM*.

^{lxvii}. See § 6.1.1 [G] and especially § 6.1.2. [R] *ELM*.

^{lxviii}. Generally a firm is not allowed to charge a fee in connection with the redemption of e-money except if the e-money scheme rules give such a right, the person seeking to redeem is informed before completion of the redemption and is given an opportunity to withdraw his request to redeem, the fee is not more than necessary to recover the e-money firm's cost of processing the redemption and never exceeds the amount of e-money offered for redemption. § 6.6.1 [R] and 6.6.2 [R] of *ELM*.

^{lxi}. Established under s. 213 FSMA for compensating persons where authorised persons are unable to satisfy claims against them.

^{lxx}. Scheme set up under Part XVI of the FSMA by which some disputes may be resolved quickly and with minimum formality by an independent person. See ss. 225 – 234 of the FSMA 2000.

^{lxxi}. See generally § 6.8 of *ELM*.

^{lxxii}. It is considered that this restricted purse limit also reduces the attractiveness of e-money for money laundering. See e.g. Nigel Miller, “E-Money Services” (2002) 146 *Solicitors Journal* 681.

^{lxxiii}. The warning, according to § 6.9.3 [R] *ELM* is that (a) the *Financial Services Compensation Scheme* does not apply to e-money issued by the firm; (b) if the e-money firm becomes insolvent the e-money in question may become valueless and unusable; and (c) if the e-money firm becomes insolvent the holder may lose his e-money.

^{lxxiv}. Although the warning is required to be given ‘in writing’, the requirement may be met by notice given electronically because, for the purposes of *ELM* and the *Handbook of Rules and Guidance* generally, a requirement for a document in writing means a document in legible form and capable of being reproduced on paper irrespective of the medium used. See § 2.2.14 [R] and 2.2.15/16 of Module *GEN* of the *Handbook of Rules and Guidance*.

^{lxxv}. See generally § 6.9 *ELM*. Additionally, § 6.9.7 [R] *ELM* provides that the final three requirements may still be met if the holder himself is responsible for the unauthorised use of his e-money device between the time of its loss or theft and notifying the firm of such.

^{lxxvi}. It is possible that, in certain circumstances, the holder of a lost consumer e-money card may be entitled to some protection under Regulation 21 of the *Consumer Protection (Distance Selling) Regulations* 2000 discussed further in section 5 below.

^{lxxvii}. § 6.3.2 [R] of *ELM*.

^{lxxviii}. By the terms of its § 1, the *Money Laundering Sourcebook* Module *ML* of the *Handbook of Rules and Guidance* applies to every ELMI. In addition it is stated in § 1(5) of *ELM* that the *FSA* is of the view that an ELMI which has an establishment in the United Kingdom is subject to the *Money Laundering Regulations* (SI 2001/3641 and SI 1993/1933).

^{lxxix}. § 6.3.3 [R] (1), 6.3.4 [R] & 6.5.1 [R] of *ELM*.

^{lxxx}. § 6.3.3 [R] (2), 6.3.4 [R] & 6.5.1 [R] of *ELM*.

^{lxxxii}. § 6.3.6 [R] of *ELM*.

^{lxxxii}. § 6.4.1 [R] of *ELM*.

^{lxxxiii}. § 6.4.2 [R] and 6.4.3 [R] of *ELM*.

^{lxxxiv}. For a judicial discussion of the features of a credit card transaction and the legal nature and effect of credit card payments, see *Re Charge Card Services Ltd* [1989] Ch. 497.

^{lxxxv}. See e.g. LS Sealey & RJA Hooley, *Commercial Law: Text, Cases and Materials* 3rd ed. (Butterworths 2003) 805.

^{lxxxvi}. The Distance selling Regulations afford protection to a consumer in some circumstances when his 'payment card' has been used fraudulently or without authorisation. Regulation 21(6) provides that 'payment card' includes credit cards, charge cards, debit cards and store cards.

^{lxxxvii}. A 'distance contract' is defined in Regulation 3 as 'any contract concerning goods or services concluded between a supplier and a consumer under an organised distance sales or service provision scheme run by the supplier who, for the purposes of the contract, makes exclusive use of one or more means of distance communication up to and including the moment at which the contract is concluded.'

^{lxxxviii}. Compare with the definition of 'card' in the latest edition of the *Banking Code* (March, 2003) which defines "card" as any plastic card used to pay for goods or services including debit, credit, cheque guarantee and charge cards but specifically excludes 'electronic purses'. Electronic purse itself is defined in the Code as a card (!) or function of a card which contains real value in the form of electronic money which someone has paid for beforehand.

^{lxxxix}. "Account" is not defined in the Code but, presumably, it refers to a bank account; cf. definition of "basic bank account" in the Code.

^{xc}. In this simplified form of the e-mail money service, as there is no issuing of e-money involved at all, the service is unlikely to be caught by the regulatory provisions concerning the regulated activity of issuing e-money. However, some of the companies offering this type of service also offer an extension of the service in that it is possible for a customer to open an account with the company for making and receiving payments. It is at least arguable, as highlighted earlier in section 3 of this article, that such a scheme falls within the definition of e-money, certainly being used to make payments to persons other than the operator and possibly being monetary value "stored on an electronic device" and "issued on the receipt of funds". In this connection it is interesting to note that at least one of the providers of this type of service, *Nochex*, is included on the 'Small e-Money issuers List' of the [FSA Register](#).

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3. Cases

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4. Statutes

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5. Subsidiary Legislation

Consumer Protection (Distance Selling) Regulations 2000 (SI 2000/2334)

Electronic Commerce Directive (Financial Services and Markets) Regulations 2002 (SI 2002/1775).

Electronic Money (Miscellaneous Amendments) Regulations 2002 (SI 2002/765)

The Financial Services and Markets 2000 (Carrying on Regulated Activities by Way of Business) Order 2001 (SI 2001/1177)

Financial Services and Markets Act 2000 (Financial Promotion) Order 2001 (SI 2001/1335)

Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (SI 2001/544)

Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2002 (SI 2002/682)

6. Directives

Directive on the Taking up, Pursuit and Prudential Supervision of the Business of Electronic Money Institutions (2000/46/EC)

Directive Relating to the Taking up and Pursuit of the Business of Credit Institutions (2000/12/EC)

7. Others

The Banking Code (March 2003) available at <www.bankingcode.org.uk>

Handbook of Rules and Guidance (FSA) available at <<http://www.fsa.gov.uk/handbook/>>

8. Links

<www.w3.org/Ecommerce/roadmap.html>

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