



COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 21.09.1998  
COM(1998) 461 final

98/ 0252(COD)  
98/ 0253(COD)

Proposal for a

EUROPEAN PARLIAMENT AND COUNCIL DIRECTIVE

**on the taking up, the pursuit and the prudential supervision of the business of  
electronic money institutions**

Proposal for a

EUROPEAN PARLIAMENT AND COUNCIL DIRECTIVE

**amending Directive 77/780/EEC on the co-ordination of laws, regulations and  
administrative provisions relating to the taking up and pursuit of the business of  
credit institutions**

(presented by the Commission)

## **Explanatory Memorandum**

### **Commission proposal for European Parliament and Council Directives on the taking up, the pursuit and the prudential supervision of the business of electronic money institutions**

#### **Introduction**

Information technology is contributing to rapid changes in the business environment generally but also, in particular, how we do business. Over the last number of years there have been several new and innovative products which have led to developments in electronic commerce. Progress in technology has contributed to the development of a new kind of payment instrument – electronic money. This may be in the form of value stored on a technical device such as a chip card or, indeed, a computer memory. Prepaid cards used as an electronic purse have the potential to replace a substantial part of cash payments over the long term. So-called Network money or software money, transferable from a personal computer, is emerging as the payment instrument for the growing electronic commerce on the Internet.

These developments have implications for the European Union both in terms of completion of the internal market and regulatory and supervisory concerns associated with the issuance of electronic money. The European Council at Cardiff invited the Commission “to table a framework for action by the time of the Vienna European Council to improve the single market in financial services, in particular examining the effectiveness of implementation of current legislation and identifying weaknesses which may require amending legislation.” The Commission proposal for a directive on the business of electronic money institutions is in the spirit of that mandate. It recognises that there is a legislative loophole in relation to electronic money issuance and aims to plug that loophole. It aims at improving the single market in financial services by introducing minimum harmonised rules and, more specifically, by introducing for electronic money institutions the concept of the single passport. It will create legal certainty, encourage new market entrants, encourage competition, and contribute generally to the development of electronic commerce.

#### **What is electronic money?**

For the purposes of this proposal electronic money can best be conceived as a digital form of cash since it has many of the characteristics of cash. The primary similarity is that to use electronic money authorisation is not required from a bank or other third party. Customers buy the electronic equivalent of coins and notes i.e. they exchange cash, on a one for one basis, for monetary value. The customer, in effect, has exchanged cash for another means of payment. Instead of using a debit card (which requires a bank account) or a credit card (which requires first the agreement of the credit card company or bank and second the appropriate advance of funds) the customer has purchased a non-cash

means of payment which can be used in much the same way as cash or other forms of card payment but without the requirement of third party authorisation.

This monetary value is stored either on a "chip" card, for example on a card similar to a phone-card, or in the form of computer software, which can be stored on the customer's PC and can be used to buy both "virtual" products over the Internet (such as music, books, computer programmes etc.) or "real" products which will be delivered to the customer's home or place of work.

Chip cards generally replace small amounts of cash and are used mainly for small purchases such as newspapers, minor grocery purchases, petrol etc. One of the benefits that electronic money has over cash and other payment instruments is the ability to make very small electronic payments, such as  $\frac{1}{4}$  or  $\frac{1}{2}$  of 1 EURO cent for downloading a page of information on the Internet.

Another major similarity with cash is anonymity. No account with a financial institution is required. Consumers can continue to purchase goods with electronic money in the same way as they can use cash without details of their name, bank, etc being disclosed to the retailer. (The Moneylaundering Directive will, of course, apply to electronic money institutions.)

The amount of electronic money, which can be stored on a chip card, is generally limited. For 19 schemes in operation in the EU the maximum limit of stored value is below 250ecu.

### **Multi-purpose pre-paid cards**

The most common form of pre-paid card is a phone card. This is a single purpose card. It represents a prepayment to the 'phone company for intended 'phone calls by the customer. However, a multi-purpose card is accepted by businesses other than the issuer of the card. This card (or computer software as outlined above) can be used in exactly the same way as cash or other means of payment such as a credit card. For example, a multi-purpose pre-paid card can be used to pay parking fees, to make 'phone calls, to purchase newspapers and magazines etc. subject only to the amount of monetary value stored on the card and, of course, acceptance by merchants.

This proposal is concerned only with multi-purpose electronic money. The directive will not cover, therefore, single purpose cards like telephone cards. The same is true for credit cards, as they do not represent stored money value.

### **International Issues**

Electronic money and its issuance is only one small, albeit important, element in the overall sphere of electronic commerce. Electronic commerce is, by its very nature, a global issue. A number of other issues, apart from electronic payments, are being discussed at international level and in various fora such as the WTO, the OECD etc. These issues concern, inter alia, encryption (security and confidentiality of information) electronic authentication (electronic signatures to facilitate certainty and security) privacy

and protection of personal data, taxation, customs duties, intellectual property rights etc. Government leaders in the G7 and G10, amongst others, encourage positive developments in electronic commerce.

As regards electronic money different approaches are being adopted. In the US for example there are no immediate plans to regulate electronic money issuance and there is, at present, no restriction on who can issue it. This approach is, in part, based on the continuing high usage of cheques as a preferred means of non-cash payment. Moreover, the size and complexity of the US economy make establishing a nation-wide system more difficult. There are, however, a growing number of limited area schemes being developed such as on college campuses, sports stadia, military bases etc.

In May of this year an interagency Task Force on Electronic Payments, chaired by the Office of the Comptroller of the Currency, was of the opinion that government regulation at this time could adversely affect competition and innovation in an industry that is still in the early stages of development and could increase the costs of electronic money products unnecessarily. They recommended that issuers of electronic money products continue to explore and develop meaningful self-regulatory approaches to deal with such key consumer issues as privacy, consumer disclosures and protection.

The issue is currently being examined in Japan where a number of large pilot schemes are already in operation or will come on line in the near future. One of the main proposals being considered is the introduction of a regulatory structure for non-bank issuance of electronic money.

The European Union now has the opportunity to establish a framework that could become the benchmark for prudential and regulatory developments in this area on the wider international stage.

### **The need for a Directive**

In relation to electronic money, the aim and mandate of the Commission is to build and help unfold the single market in financial services. The focus is on removing barriers for carrying on financial business activities across borders, to follow developments of new techniques and products, allowing their free circulation without unjustified burdens. At the same time the Commission is conscious of the regulatory and supervisory issues associated with electronic money issuance.

The financial integrity and the operations of electronic money issuers must be secured. On the one hand we must ensure the stability and soundness of issuers of electronic money. On the other hand we must ensure that the failure of any one individual issuer does not result in loss of confidence in this new and developing means of payment.

The development of e-money schemes in Europe started in the late 80s/early 90s with pilot schemes in a small number of Member States. However, projects developed rapidly from the mid-1990s. For example, in the early stages of development there were only small pilot schemes in three Member States. This had increased to 24 multi-purpose money schemes operating in the Union by the end of 1996 with only three Member States having no scheme at all. It is anticipated that with increasing usage even more new schemes will be developed.

Against this background, the supervisory and regulatory approaches to the issuance of e-money have developed on an ad hoc, national basis throughout the Union. There is no clear legal framework for electronic money issuance and if the regulatory issues are not addressed this business can be carried out on an unregulated basis. It is neither in the interests of consumers nor markets generally that this situation be allowed to continue.

Apart from commitments given in previous Communications from the Commission to introduce a regulatory regime for the issuance of electronic money there are other reasons why this issue should be addressed without delay.

- Electronic money presents an opportunity for consumers to familiarise themselves with the concept of the single currency – in the absence of EURO notes and coins until 2002 consumers and retailers, by availing of electronic money schemes, will be able to buy and sell in EURO in the intervening period. This will also contribute to the growth and development of electronic money as a simple means of cross-border payment. Although there is as yet no fully functional cross-border system in operation several of the existing systems are capable of being used on a cross-border basis. Moreover, once the legal certainty provided by the proposal is established, an increase in cross-border interoperable systems is expected.
- Member States have started to develop rules and regulations at the national level in relation to electronic money issuers. There is, therefore, a risk that different approaches at the national level will make harmonisation all the more difficult in two or three years time.

Given the potential development of cross-border e-money schemes, fostered not only by developments in information technology but notably by the introduction of the EURO, it is necessary to address the question whether, subject to certain minimum supervisory controls, non-bank entities, to which the freedom of providing cross-border e-money services is already provided for by Article 59 of the Treaty on European Union, should be allowed to provide cross-border e-money services under a concept of mutual recognition of home supervision in the framework of harmonised prudential rules as are applied to credit institutions. For these latter institutions cross-border operation of e-money schemes is already permitted under the terms of the Second Banking Co-ordination Directive.

The Commission has therefore decided to take a proactive approach to this issue. This proposal will create a harmonised single market in the provision of electronic money in the European Union. It will reinforce stability and substantially eliminate the associated prudential risks. The proposal is timely not only to create legal certainty for potential market entrants but also from the perspective of the single currency.

### **The Regulatory issues**

There is much debate about the potential for electronic money, both card based and computer based. In terms of electronic commerce expectations are very high. For

example, the results of research by one organisation<sup>1</sup> suggest that Internet payments will grow from approximately \$518 million in 1998 to \$6.6 billion by the year 2000. These figures are not untypical of other research results.

The level of individual payments can be quite small and, indeed one of the attractions of electronic money is that it can be used to make micro-payments (for example, 0.5 of one EURO cent per page on the Internet). However, in terms of overall exposure it is evident that a substantial amount of electronic money could be in circulation exposing consumers, but especially traders and retailers, to failure and, in this event, the possibility of systemic risk.

The present proposal deals only with the prudential and regulatory issues concerning electronic money issuers and sets out requirements to be applied to issuers of electronic money products in order to ensure their stability and soundness. The legal and contractual relationship between consumers and electronic money institutions is being examined separately and is dealt with in more detail below.

As well as considerations concerning completion of the single market and the removal of barriers to trade, the Commission is conscious to ensure a level playing field between different types of institution. It is clear that traditional credit institutions too will play an important role in this segment of retail financial business and therefore, the fundamental rules concerning free circulation under the principle of mutual recognition and the supervisory regime to which they are subject, such as authorisation, capital requirement, supervision etc. should also be applied in an appropriate way to electronic money institutions.

The regulatory regime must be such so as to achieve the highest degree possible of a level playing field between different types of institution while at the same time not being overly burdensome so as to impede or hamper the development of this new industry. This is the aim of the current proposal.

The Banking Advisory Committee as well as financial institutions, electronic money institutions, service providers and other interested parties were consulted on the general framework proposed. While there was not unanimity, there was broad agreement on the general approach being adopted.

### **Monetary Policy**

In preparation of this proposal it emerged that due account must be taken of the potential implications of e-money issuance for the conduct of monetary policy. Concern was expressed that the possibility must exist for central banks to impose reserve requirements on all issuers of electronic money, in particular in order to be prepared for a substantial development of electronic money with a material impact on monetary policy.

The Governing Council of the European Central Bank recently identified three main functions which a minimum reserve system could usefully perform in Stage 3 of EMU.

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<sup>1</sup> Forrester Research

One of those main functions was that "...such system could contribute to enlarging the demand for central bank money and thus creating or enlarging structural liquidity shortage in the market; this is considered helpful in order to improve the ability of the ESCB to operate efficiently as a supplier of liquidity and, in the longer term, to react to new payment technologies such as the development of electronic money."<sup>2</sup>

The proposal by the Commission to amend the definition of credit institution in the First Banking Directive to allow institutions, which are not willing to enter into full banking operations to issue electronic money under the fundamental rules governing all other credit institutions will promote the harmonious development of the activities of credit institutions throughout the Community, in particular as regards the issuance of electronic money, and will avoid distortion of competition between electronic money institutions even as regards the application of monetary policy requirements. The ECB has got the necessary powers to apply, or not to apply these requirements.

### **Why a different regime for non-banks ?**

In the area of banking, the single market in the provision of services was achieved by introducing the single licence regime based upon a minimum harmonisation of prudential supervision. The Commission draft proposals for directives on the issuance of electronic money follow that same route and are very much calibrated on the existing banking directives. The main thrust is to provide for the application of those elements of banking legislation, and only those, which are pertinent to the provision of e-money and to the risks associated with it while at the same time ensuring, from a monetary policy perspective, that both stability and a level playing field as between issuers are realised.

This approach is in line with the principles followed until now. European banking legislation always acknowledged that there are differences between institutions. For such targeted regulation reflecting peculiarities of certain institutions it is of course important that it does not undermine the level playing field. The suggested supervisory regime is certainly less cumbersome than that applying to banks. However, competitive advantages in terms of reduced compliance cost are balanced by stringent restrictions, both in terms of business activities and investments of non-bank providers.

The principal differences between the application of the First and Second Banking Coordination Directives to banks and electronic money institutions lies in the initial capital and on-going own funds requirements and the investment limitations imposed on them. The initial capital requirement for banks is 5 million ECU while that proposed for electronic money institutions is set at 500,000 ECU. On an on-going basis banks are required to maintain a minimum own-funds requirement of 8% while the figure proposed for electronic money institutions is set at 2%.

The business activities and investment capabilities of electronic money institutions are substantially different from those applying to banks. On the one hand it is important to

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<sup>2</sup> European Central Bank, Press Release "The use of a minimum reserve system by the European System of Central Banks in Stage Three" 08.07.1998

set an initial capital requirement at a level that will not discourage new market entrants and one which reflects the relative risks involved while on the other hand it is important to limit the on-going own-funds requirement to a level that will not adversely affect profitability. These lower thresholds for electronic money institutions are balanced by strict limitations on their investment portfolio.

The Banking Advisory Committee was consulted and acknowledged that investments of funds by electronic money institutions must reflect the fact that the funds serve as the necessary backing in order for the issued e-money to be accepted as a reliable, cash equivalent payment means but cautioned against an overly complex approach. At a technical level National experts generally agreed that the indicated amounts were of a reasonable order.

By using this approach the Commission aims to promote competition in the evolving European e-money market and to allow that market to drive the pace of development and innovation and to offer a quality product that meets the expectations of consumers and is competitive at the wider international level while at the same time not distorting competition between credit institutions issuing electronic money.

The objective of the proposals is pro-competitive; it will naturally be important to monitor the development of the e-money sector to see if specific interventions are necessary in order to promote or maintain competition.

### **Consumer Issues**

On July 9<sup>th</sup> 1997 the European Commission published a Communication "Boosting Customers' Confidence in Electronic Means of Payment".<sup>3</sup> That Communication referred to the link between electronic commerce and new payment instruments which had been highlighted in an earlier Communication, "A European Initiative in Electronic Commerce"<sup>4</sup> It identified four main areas where "a substantial contribution by public authorities is called for as regards electronic payments". Those four areas are set out again here.

Action (i) They must define the supervisory framework appropriate for the issuance of electronic money so as to ensure the stability and soundness of issuers;

Response: This is the content of the current proposal.

Action (ii) They must provide guidance for issuers and users, on transparency, liability and redress procedures, in order to ensure the full confidence of users.

Response: Attached to the Communication was addressed a Recommendation to the Member States concerning transactions by electronic payment instruments and in particular the relationship between issuer and holder. Amongst the issues addressed in

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<sup>3</sup> COM (97) 353 Final

<sup>4</sup> COM (97) 157 Final, 15.04.97

that Recommendation were transparency of conditions for transactions, including minimum information on terms and conditions; obligations and liabilities of the parties to a contract including obligations and liabilities of the issuer and holder; and settlement of disputes procedures.

Member States were invited to implement the terms of the Recommendation no later than December 31<sup>st</sup> 1998. The Commission has undertaken to examine the implementation of that Recommendation by the Member-States and will take whatever action is necessary in light of that study.

Action (iii) They must clarify the application of the Community's competition rules so as to achieve an appropriate balance between interoperability and sound and vigorous competition in these markets.

Response: The Commission, in the light of notifications already received, is currently examining the competition rules governing interoperability.

Action (iv): They must tackle the risks of fraudulent use and counterfeiting, by improving security.

Response: On July 1<sup>st</sup> 1998 a Communication from the Commission on A Framework for Action on Combating Fraud and Counterfeiting of non-cash means of payment was issued. The aim of the Joint Action plan contained in that Communication is to ensure that fraud and counterfeit of non-cash means of payment is recognised as a criminal offence in all Member States and set out a range of measures to be taken at National level. There is a commitment for an assessment of the implementation of the framework by the Council based on a report from the Commission by the end of 2000.

In the context of consumer issues it is appropriate to emphasise that the electronic money instruments covered by the current proposal do not represent a deposit. Unlike a depositor, a user does not advance funds to an issuer in order to ensure their safe keeping and handling. Neither the issuer nor the customer pursues this objective. The underlying contract between the customer and the issuer is that the user will get value for the electronic money from those merchants that accept it and that the issuer will honour his commitment to give value.

The issue of reimbursement does not arise in the normal course of events. The customer is making an advance payment for, as yet, undetermined goods and services in the same way as a customer who purchases a 'phone card has not determined when or where the calls will be made.

The nature of the contract between the issuer and the holder will clearly establish the legal relationship between them. Specific terms, conditions, and other transaction rules, including the possibility of reimbursement, if any, may be determined under the contractual agreement of each electronic money scheme. The contractual provision of reimbursement, if convened, does not change the nature of the contract, because the purpose of the contract does not change; it remains the purchase and sale of electronic money and related payment services.

This proposal is concerned with the prudential and regulatory issues of electronic money. Nevertheless, the consumer related issues will be addressed in a separate Communication followed by specific legislation, if necessary.

## **Conclusion**

Electronic money has the potential to develop into an efficient and effective means of payment; it can play a significant role in the development and improvement of electronic commerce; and it can be an important tool in the completion of the single market and monetary union. The Commission is of the view that it is in the interests of both business and consumers alike that electronic money develops within a regulatory environment that instils trust and confidence in this new and developing payment instrument. At the same time it is vital that development is allowed to take place unimpaired by strict technological rules which will hamper innovation and restrict competition.

The Commission proposal on the taking-up, the pursuit and the prudential supervision of the business of electronic money institutions introduces the regulatory regime necessary to ensure the financial integrity of non-bank issuers without stifling developments in the domain of electronic money and will help to cultivate an environment in which the development of this new means of payment is promoted in the interests of business and consumers.

## **Outline of the draft directives.**

### **Scope**

The amendment to the First Banking Directive defines electronic money institutions as credit institutions thus submitting them to the provisions of the First and Second Banking Co-ordination Directives thereby allowing them the European Passport. At the same time it creates a level playing field as between different types of credit institution. Because of the limited scope of the business of electronic money institutions some of the provisions of the banking directives are not applied or are more limited in their application. These provisions are set out in the ad hoc directive.

As regards the ad hoc directive itself, in line with the Commission's proposed regulatory approach **Article 1** suggests a limited scope of application restricting harmonisation of regulation to 'electronic money institutions', i.e. non-bank providers of e-money services.

Electronic money is defined in such a way as to cover prepaid cards and network money, however, only if issuance is within a 3-party system, i.e. if the electronic monetary value is accepted as a means of payment by undertakings other than the issuing institution(s).

The business of electronic money institutions, other than the issuance of electronic money, is restricted to the provision of closely related financial and non-financial services, such as administering electronic money; performing operational or ancillary functions; issuing and administering other means of payment. The provision of non-financial services delivered through the electronic device is permitted.

### **Application of Banking Directives**

Responding to the specific nature of e-money institutions and corresponding regulatory needs **Article 2** fully or partly waives application of some of the 40 Articles of the First and Second Banking directives. Yet, for the taking up and pursuit of business, e-money institutions are subject to the same conditions as credit institutions. Requirements as for credit institutions apply notably with respect to

- prior authorisation;
- minimum capital requirements (on a reduced basis);
- fit and proper management;
- sound and prudent operation;
- initial and ongoing owner control.

**Article 2** clarifies that, except for the Money Laundering Directive and the Consolidated Supervision Directive, other EU banking legislation does not apply to e-money institutions unless this is specifically provided for.

Thus, subject to compliance with the requirements pursuant to Articles 3 to 6 regarding notably restrictions of activities, limitations on investments and adequate own funds, e-money institutions would fully benefit from the freedom of establishment and provision of services as provided for in the 2BD.

Article 2 also provides that the contractual arrangements must specify if the stored value is redeemable and, if so, the specific contractual conditions.

#### **Initial Capital and on-going Own Funds Requirements**

**Article 3** introduces ongoing own funds requirements. These requirements are necessary in order to ensure that e-money institutions have own funds commensurate with the size of their operation. The suggested yardstick is set at 2% of the higher of the institution's current amount or the average of the preceding 6 months total amount of unredeemed e-money issued by the institution in question. In any event the amount may not fall below the initial capital requirement of 500,000 ECU.

#### **Limitations of Investments**

**Article 4** proposes limitations on investments that reflect the need for a prudent investment policy of issuers of e-money, to contain in particular the exposure to liquidity risks of issuers. Accordingly, the proposal requires that funds received in exchange for issued electronic money should be invested only in highly liquid assets which attract a 0% credit risk weighting in accordance with the Solvency Ratio Directive. Hedging of market risks by highly liquid exchange-traded derivative instruments subject to a 0% credit risk capital charge would also be allowed.

In addition, electronic money institutions may invest in other highly liquid debt instruments and have ancillary liquidity in the form of sight deposits held with Zone A credit institutions. However, such investments are subject to a ceiling of twenty times the institutions' own funds and subject to large exposure limitations as least as stringent as those imposed on banks.

The limitations on investments respond to the need of imposing a relatively low-risk investment policy, which appropriately reflects the liquidity risks to which electronic money institutions are exposed. The imposition of this low-risk investment requirement helps to ensure the stability and soundness of the issuers thereby protecting the e-money system and consumers in general.

**Article 5** imposes a requirement on competent authorities to verify compliance by e-money institutions with Articles 3 and 4 at least twice each year while **Article 6** emphasises the obligation to have sound and prudent operations.

#### **Waiver**

**Article 7** affords an option to the Member States allowing for a waiver of certain of the provisions of the proposals commensurate with the risks inherent in small e-money schemes. The waiver may only be applied to e-money institutions underpinning relatively small schemes.

The underlying considerations are that the overall unredeemed e-money does not exceed ECU 10 million of unredeemed e-money and that the storage device has a capacity of ECU 150 of maximum loading amount.

The waiver only applies to business activities (Article 1(4)), application of the First and Second Banking Directives (Article 2(1)), initial capital and own funds requirements (Article 3(1)) and Article 8 which requires existing electronic money schemes to submit information to the competent authorities.

Such small schemes will not benefit from the passport provisions. They will, however, continue to be subject to the other provisions such as limitations on investments, limited ongoing own funds requirements, an obligation to have sound and prudent operations, semi-annual reporting requirements and application of Money Laundering Directive etc..

#### **Grandfathering**

**Article 8** provides for a grandfathering as regards the authorisation requirement for e-money institutions already operating at the date of the coming into force of national provisions implementing the European regulation.

The remaining Articles are the standard implementation and notification provisions.

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THE EUROPEAN PARLIAMENT AND THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular the first and third sentences of Article 57(2) thereof,

Having regard to the proposal from the Commission,<sup>5</sup>

Having regard to the opinion of the Economic and Social Committee,<sup>6</sup>

Acting in accordance with the procedure referred to in Article 189b of the Treaty,<sup>7</sup>

Whereas credit institutions within the meaning of Article 1, first indent, (b) of Council Directive 77/780/EEC,<sup>8</sup> as last amended by European Parliament and Council Directive 98/.../EC<sup>9</sup> are limited in the scope of their activities;

Whereas, it is necessary to take account of the specific characteristics of these institutions and to provide the appropriate measures necessary to co-ordinate and harmonise Member States' laws, regulations and administrative provisions relating to the taking up, the pursuit and the prudential supervision of the business of electronic money institutions;

whereas the approach adopted is appropriate to achieve only the essential harmonisation necessary and sufficient to secure the mutual recognition of authorisation and prudential supervision of electronic money institutions, making possible the granting of a single license recognized throughout the Community and the application of the principle of home Member State prudential supervision;

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<sup>5</sup> OJ No C....

<sup>6</sup> OJ No C....

<sup>7</sup> Opinion of the European Parliament of ...(OJ No C....) , common position of the Council of ...(OJ No C....) and decision of the European Parliament of ...(OJ No C....)

<sup>8</sup> OJ L322, 17.12.1977, p30

<sup>9</sup> OJ L ....

whereas within the wider context of the rapidly evolving electronic commerce it is desirable to provide a regulatory framework that assists electronic money in delivering its full potential benefits and that avoids hampering technological innovation in particular; whereas, therefore, this Directive introduces a technology-neutral legal framework that harmonises the prudential supervision of electronic money institutions to the extent necessary for ensuring their sound and prudent operation and their financial integrity in particular;

whereas credit institutions, by virtue of point 5 of the Annex to Council Directive 89/646/EEC<sup>10</sup> as last amended by directive 92/30/EEC<sup>11</sup>, are already allowed to issue and administer means of payment including electronic money and to carry on such activities Community-wide subject to mutual recognition and to the comprehensive prudential supervisory system applying to them in accordance with the European banking Directives;

whereas the introduction of a separate prudential supervisory regime for electronic money institutions, which although calibrated on the prudential supervisory regime applying to credit institutions and Directives 77/780/EEC and 89/646/EEC in particular, differs from that regime, is justified and desirable because the issuance of electronic money cannot, in view of its specific character as an electronic surrogate for coins and banknotes, be regarded as a deposit-taking activity prohibited pursuant to Article 3 of Directive 89/646/EEC to undertakings other than credit institutions;

whereas in order to respond to the specific risks associated with the issuance of electronic money this prudential supervisory regime must be more targeted and, accordingly, is less cumbersome than the prudential supervisory regime applying to credit institutions, notably as regards reduced initial capital requirements and the non-application of Directives 89/647/EEC<sup>12</sup>, 92/121/EEC<sup>13</sup> and 93/6/EEC<sup>14</sup>;

whereas, however, it is necessary to preserve a level playing field between credit institutions issuing electronic money and electronic money institutions and, thus, to ensure fair competition among a wider range of institutions to the benefits of users; whereas this is achieved since the above-mentioned less cumbersome features of the prudential supervisory regime applying to electronic money institutions are balanced by provisions that are more stringent than those applying to credit institutions, notably as regards restrictions of the business activities electronic money institutions may carry on and, particularly, prudent limitations of their investments aimed at ensuring that their financial liabilities related to outstanding electronic money are backed at all times by highly liquid low risk assets;

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<sup>10</sup> OJ L386, 30.12.1989, p1

<sup>11</sup> OJ L110, 28.04.1992, p52

<sup>12</sup> OJ L386, 30.12.1989, p14

<sup>13</sup> OJ L29 05.02.1993, p1

<sup>14</sup> OJ L141, 11.06.1993, p1

whereas with a view to the possibility of operational and other ancillary functions related to the issuance of electronic money being performed by undertakings which are not subject to prudential supervision it is appropriate to afford competent authorities certain powers with respect to these undertakings;

whereas it is appropriate to afford competent authorities the possibility to waive certain requirements imposed by this Directive for electronic money institutions which operate only within the territories of the respective Member State and whose business activities do not exceed certain thresholds;

whereas adoption of this Directive constitutes the most appropriate means of attaining the desired objectives; whereas this Directive is limited to the minimum necessary to attain these objectives and does not go beyond what is needed for this purpose;

whereas the Banking Advisory Committee has been consulted on the adoption of this Directive;

HAVE ADOPTED THIS DIRECTIVE:

## **Article 1**

### **Scope, definitions and restriction of activities**

- (1) This Directive shall apply to electronic money institutions.
- (2) It shall not apply to the institutions referred to in Article 2 (2) of Directive 77/780/EEC.
- (3) For the purposes of this Directive:
  - (a) 'electronic money institution' shall mean an undertaking, other than a credit institution as defined in article 1, first indent, (a) of Council Directive 77/780/EEC which issues means of payment in the form, of electronic money or which invests the proceeds from such activities without being subject to Council Directive 93/22/EEC<sup>15</sup>;
  - (b) 'electronic money' shall mean monetary value which is:
    - (i) stored electronically on an electronic device such as a chip card or a computer memory;
    - (ii) accepted as means of payment by undertakings other than the issuing institution;
    - (iii) generated in order to be put at the disposal of users to serve as an electronic surrogate for coins and banknotes; and

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<sup>15</sup> OJ L141, 11.06.1993, p27

(iv) generated for the purpose of effecting electronic transfers of limited value payments.

2. (4) The business activities of electronic money institutions other than the issuing of electronic money shall be restricted to:

(a) the provision of closely related financial and non-financial services such as the administering of electronic money by the performance of operational and other ancillary functions related to its issuance and the issuing and administering of other means of payment within the meaning of point 5 of the Annex to Directive 89/646/EEC; and

(b) the provision of non-financial services that are delivered through the electronic device.

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

## Article 2

### Application of Banking Directives

- (1) Save where otherwise expressly provided for, references to credit institutions in EC regulations, directives other than Directives 77/780/EEC and 89/646/EEC, recommendations and opinions shall not apply to electronic money institutions..
- (2) Articles 2 (5) and (6), 3 (3) b), c) and d) and (7), 4, 6, 7 (2) and (3), 8 (2), (3) and (4), 10 and 14 of Directive 77/780/EEC and Articles 4, 6, 10, 12, 18 (2), 23 and 24 of Directive 89/646/EEC shall not apply. The freedom of establishment and the freedom to provide services according to Articles 18 to 21 of Directive 89/646/EEC shall not apply to electronic money institutions' business activities other than the issuance of electronic money.
- (3) Council Directives 91/308/EEC<sup>16</sup> and 92/30/EEC<sup>17</sup> shall apply to electronic money institutions.
- (4) For the purpose of applying Article 3 of Directive 89/646/EEC funds received in exchange for electronic money shall not be regarded as deposits within the meaning of that Article if the underlying contractual arrangements:
  - (a) clearly establish the specific character of electronic money as an electronic surrogate for coins and banknotes; and

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<sup>16</sup> OJ L166, 28.06.1991, p77

<sup>17</sup> OJ L110, 28.04.1992, p52

(b) do not provide for the possibility of advancing funds with a view to and in exchange for the receipt of electronic money at a later stage.

Redeemability of electronic money is, in itself, not a sufficient reason for considering the funds advanced by the user to be deposits within the meaning of Article 3 of Directive 89/646/EEC. The contract between the issuer and the user shall define if the stored electronic money is redeemable or not, and, if appropriate, the conditions, the formalities and the time period of redeemability.

### **Article 3**

#### **Initial capital and ongoing own funds requirements**

- (1) Electronic money institutions shall have an initial capital of no less than ECU 500,000. Notwithstanding paragraphs 2 and 3 below their own funds shall not fall below that amount.
- (2) Electronic money institutions shall have at all times own funds equal to or above 2% of the higher of the current amount or the average of the preceding 6 months' total amount of their financial liabilities related to outstanding electronic money.
- (3) Where an electronic money institution has not completed a 6 months period of business, including the day it starts up, it shall have own funds equal to or above 2% of the higher of the current amount or the 6 months target total amount of its financial liabilities related to outstanding electronic money. The 6 months target total amount of the institution's financial liabilities related to outstanding electronic money shall be evidenced by its business plan subject to any adjustment to that plan having been required by the competent authorities.

### **Article 4**

#### **Limitations of investments**

- (1) Electronic money institutions shall have investments of an amount of no less than their financial liabilities related to outstanding electronic money in the following assets only:
  - (a) asset items which according to Article 6 (1) (a) points 1, 2, 3, 4 and Article 7 (1) of Directive 89/647/EEC attract a zero credit risk weighting and which are highly liquid;
  - (b) sight deposits held with Zone A credit institutions and debt instruments, which are
    - (i) highly liquid;
    - (ii) not covered by paragraph 1 point (a),

(iii) recognised by competent authorities as qualifying items within the meaning of Article 2 (12) of Directive 93/6/EEC, and

(iv) issued by undertakings other than undertakings which have a direct or indirect holding in the electronic money institution concerned or which must be included in these undertakings' consolidated accounts or in which the electronic money institution concerned has a direct or indirect holding.

- (2) Investments referred to in paragraph 1 point (b) may not exceed twenty times the own funds of the electronic money institution concerned and shall be subject to limitations which are at least as stringent as those applying to credit institutions in accordance with Directive 92/121/EEC.
- (3) For the purpose of hedging market risks arising from the issuance of electronic money and from the investments referred to in paragraph 1 electronic money institutions may use highly liquid interest-rate and foreign-exchange-related off balance-sheet items in the form of exchange-traded derivative instruments to which Annex II to Directive 89/647/EEC does not apply. The use of derivative instruments according to the first sentence is permissible only if the full elimination of market risks is intended and, to the extent possible, achieved.
- (4) Member States shall impose appropriate limitations on the market risks electronic money institutions may incur from the investments referred to in paragraph 1.
- (5) For the purpose of applying paragraph 1 assets shall be valued at the lower of cost or market value.
- (6) If the value of the assets referred to in paragraph 1 falls below the amount of financial liabilities related to outstanding electronic money the competent authorities shall ensure that the electronic money institution in question takes appropriate measures to remedy that situation promptly. To this end, and for a temporary period only, the competent authorities may allow the institution's financial liabilities related to outstanding electronic money to be backed by assets other than those referred to in paragraph 1 up to an amount not exceeding the lower of 5% of these liabilities and the institution's total amount of own funds.

## **Article 5**

### **Verification by competent authorities**

Competent authorities shall verify compliance with Articles 3 and 4 not less than twice each year on the basis of data supplied by the electronic money institutions.

## Article 6

### Sound and prudent operation

- (1) Electronic money institutions shall have sound and prudent management, sound administrative and accounting procedures and adequate internal control mechanisms. These should respond to the financial and non-financial risks to which the institution is exposed.
- (2) If an electronic money institution undertakes business activities of the type referred to in Article 1 (3) point (a) in co-operation with another undertaking which performs operational or other ancillary functions related to these business activities and which, with a view to the risks related to these functions, is subject to no prudential supervision, the contractual arrangements underlying this co-operation shall provide for contractual rights which enable the electronic money institution properly to monitor and contain these risks and immediately and unconditionally to cancel the contractual arrangements underlying the co-operation if the effective exercise of these rights is impaired in practice or upon request of the competent authorities in accordance with paragraph 3 last indent.
- (3) In order to ensure the effective supervision of an electronic money institution which co-operates with another undertaking in the manner described in paragraph 2, Member States shall provide that their competent authorities may:
  - (a) require that other undertaking to supply any information which would be relevant for the purpose of supervising the electronic money institution;
  - (b) carry out, or have carried out by external inspectors, on-the-spot inspections of that other undertaking to verify such information; and
  - (c) require as appropriate the electronic money institution promptly to remedy any shortcomings and if necessary immediately to cancel the contractual arrangements underlying the co-operation with that other undertaking.

## Article 7

### Waiver

- (1) Member States may waive the application of Articles 1 (4), 3 (1), and 8 of this Directive and the application of Directives 77/780/EEC and 89/646/EEC to an electronic money institution if the totality of the business activities of the type referred to in Article 1 (3) point (a) it undertakes alone or in co-operation with other electronic money institutions fulfil the following conditions:
  - (a) it generates a total amount of financial liabilities related to outstanding electronic money that normally does not exceed ECU 10 million and never exceeds ECU 12 million; and
  - (b) is related to electronic money the underlying contractual arrangements of which provide that the electronic storage device at the disposal of users for the purpose of

making payments is subject to a maximum storage amount of no more than ECU 150.

An electronic money institution for which the application of one of the above Articles has been waived shall not benefit from the freedom of establishment and the freedom to provide services as conveyed by Directive 89/647/EEC.

(2) For the purpose of applying this Directive to undertakings which seek for a waiver according to paragraph 1 to be approved or for which the waiver has been approved:

(a) 'competent authorities' shall mean those national authorities which are responsible for the supervision of electronic money institutions; and

(b) 'own funds' shall mean own funds as defined in Council Directive 89/299/EEC<sup>18</sup>.

### **Article 8**

#### **Grandfathering**

- (1) Electronic money institutions subject to this Directive which have commenced their activity in accordance with the provisions in force in the Member States in which they have their head offices before the entry into force of the provisions adopted in implementation of this Directive shall be presumed to be authorised. The Member States shall oblige such electronic money institutions to submit, within a reasonable period, all relevant information in order to allow the competent authorities to assess whether the institutions comply with the requirements pursuant to this Directive, which measures need to be taken in order to ensure compliance, or whether a withdrawal of authorisation is appropriate.
- (2) The presumption according to paragraph 1 first sentence shall not apply to electronic money institutions which benefit from a waiver in accordance with Article 7. If such a waiver is subject to prior approval by competent authorities the presumption shall become void by the time of that approval.

### **Article 9**

- (1) Member States shall bring into force the laws, regulations and administrative provisions necessary to comply with this Directive by 31 December 1999 at the latest. They shall immediately inform the Commission thereof.

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<sup>18</sup> OJ L124, 05.05.1989, p16

When Member States adopt these measures, these shall contain a reference to this Directive or shall be accompanied by such reference at the time of their official publication. The procedure for such reference shall be adopted by Member States.

- (2) Member States shall communicate to the Commission the text of the main provisions of national law which they adopt in the field covered by this Directive.

#### **Article 10**

This Directive shall enter into force on the twentieth day following that of its publication in the Official Journal of the European Communities.

#### **Article 11**

This Directive is addressed to the Member States.

Done at Brussels,

For the European Parliament

The President

For the Council

The President

**Proposal for a**

98/ 0253(COD)

**European Parliament and Council Directive**

**amending Directive 77/780/EEC on the co-ordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions**

THE EUROPEAN PARLIAMENT AND THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular the first and third sentences of Article 57(2) thereof,

Having regard to the proposal from the Commission,<sup>19</sup>

Having regard to the opinion of the Economic and Social Committee,<sup>20</sup>

Acting in accordance with the procedure referred to in Article 189b of the Treaty,<sup>21</sup>

whereas, in accordance with the objectives of the Treaty, it is desirable to promote harmonious development of the activities of credit institutions throughout the Community, in particular as regards the issuance of electronic money;

whereas certain institutions limit their activity primarily to the issuance of electronic money; whereas to avoid any distortion of competition between electronic money issuers, even as regards application of monetary policy measures, it is advisable that these institutions, subject to suitable specific provisions taking into account their special characteristics, are brought within in the scope of Council Directive 77/780/EEC<sup>22</sup>, last amended by Directive 96/13/CE<sup>23</sup> and Council Directive 89/646/EEC<sup>24</sup> ;

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<sup>19</sup> OJ No C....

<sup>20</sup> OJ No C....

<sup>21</sup> Opinion of the European Parliament of ... (OJ No C....), common position of the Council of ... (OJ No C....) and decision of the European Parliament of ... (OJ No C....)

<sup>18</sup> OJ L322, 17.12.1977, p30

<sup>23</sup> OJ L66, 16.03.1996, p15

<sup>24</sup> OJ L386, 30.12.1989, p1

whereas it is advisable, consequently, to extend to these institutions the definition of credit institutions provided for in Article 1 of Directive 77/780/EEC;

whereas Directive 98/.../ EC, of the European Parliament and the Council,<sup>25</sup> which coordinates and harmonises suitable specific provisions of access to the activity and its exercise as well as the prudential supervision of these institutions, defines those as electronic money institutions;

HAVE ADOPTED this DIRECTIVE

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<sup>25</sup> OJ L .....

## **Article 1**

Article 1, first indent, of Directive 77/780/EEC is replaced by the following text:

- "credit institution" means:

- (a) an undertaking whose business is to receive deposits or other repayable funds from the public and to grant credits for its own account; or
- (b) an electronic money institution within the meaning of Directive 98/.../ EC of the European Parliament and the Council.

## **Article 2**

The Member States shall adopt the measures necessary to comply with this Directive as soon as may be after its publication in the Official Journal. They shall forthwith inform the Commission thereof.

When Member States adopt these provisions they shall contain a reference to this Directive or be accompanied by such a reference at the time of their official publication. The procedure for such reference shall be adopted by Member States.

## **Article 3**

This directive shall enter into force 20 days after the date of publication in the Official Journal of the European Communities.

## **Article 4**

This Directive is addressed to the Member States.

**Done at Brussels**

*For the European Parliament*  
*The President*

*For the Council*  
*The President*

## FINANCIAL STATEMENT

**The proposal has no cost implications for the budget of the European Union.**

## IMPACT ON COMPETITIVENESS AND EMPLOYMENT

1. What is the main justification for the measure?

The purpose of the proposed directive is to introduce a regulatory framework for the business of electronic money institutions which aims to ensure the stability and soundness of issuers, thereby ultimately safeguarding customers' interests.

2. Characteristics of the enterprises concerned

The proposed directive creates a new form of credit institution, i.e. "electronic money institutions" which issue electronic means of payment or who invest the proceeds of that activity without being subject to the Investment Services Directive.

3. What are the obligations imposed directly on enterprises?

The proposal imposes obligations in relation to authorisation by competent authorities; initial capital and on-going own funds requirements; limitations of investments; verification by competent authorities; and, sound and prudent operations.

4. What obligations are likely to be imposed on enterprises through local authorities?

None.

5. Are there any special measures for SMEs, If so, what type of measures are they?

None.

6. What is the likely effect on:

(a) the competitiveness of enterprises?

(b) employment?

(a) The proposal, by establishing a legal framework for electronic money issuance, is likely to encourage further development and innovation in this field. This should have positive effects not only on the issuing institutions themselves but also on related enterprises associated with technological hardware and software development. Moreover, the proposal removes any legal uncertainty that may have been associated with cross-border issuance. It should, therefore, increase competition in the business of electronic money specifically and payment instruments generally. Electronic money also has the potential to reduce the costs of cash handling for enterprises generally.

(b) The effects on employment should be positive. The increase in the both the number of institutions and volume of business as a consequence of the legal framework created by the directive, on a domestic as well as a cross-border basis, could be expected to generate employment.

7. Have the two sides of industry been consulted? What are their views?

No. The proposed measures affect only the prudential regulation of electronic money issuers.

8. What are the costs and benefits of the proposal?

Costs: no costs, other than legislative ones, are to expected.

Benefits: (1) Creation of a regulatory framework to ensure the stability and soundness of issuers; this should increase business and consumer confidence in this new and developing means of payment. (2) Elimination of legal uncertainty created by the lack of harmonisation in this field. (3) Completion of the Internal Market: the proposal

will facilitate access by electronic money institutions from one EC Member State, into another EC Member State (remotely or via a branch), contributing to the free movement of capital and to the freedom of cross-border services. (4) Adding to the legal framework in which the European Central Bank may develop its monetary policy.

**Balance: overwhelmingly on the benefit side.**

ISSN 0254-1475

COM(98) 461 final

# DOCUMENTS

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Catalogue number : CB-CO-98-541-EN-C

ISBN 92-78-39365-7

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Office for Official Publications of the European Communities

L-2985 Luxembourg