

European Commission  
Directorate General Internal Market  
C107 01/04  
B – 1049 Brussels  
Belgium

13 February 2004

Dear Sirs,

### **New Legal Framework for Payments in the Internal Market**

I refer to the consultative document issued on 2 December 2003. Our response to the proposals is set out below.

PayPal (Europe) Ltd (PPEL) was authorised as an electronic money institution by the FSA in the UK with effect from 12 February 2004 and is now the entity within the eBay/PayPal group responsible for the PayPal service to all users based in the EU.

We have not provided comments on all Annexes. Where an Annex is not referred to below, it can be assumed that we have no comments.

#### General Comments

PPEL is generally supportive of the objectives of the initiative provided that the core requirements of a level regulatory playing field and technical neutrality are maintained in the process.

A wide range of issues is covered by Annexes 1 to 21. Many of the areas covered do not yet appear to have been considered in detail and could not form the basis for any legislative proposals without significant analysis going beyond the current round of consultation. This is particularly the case given the proposal to implement the proposals in the form of a Regulation. Although implementation by Regulation would have certain advantages as identified in the consultation document, the additional detail required and the absence of any flexibility requires that the proposals be thought through to a greater level of detail than would be the case with implementation via a Directive.

Some of the areas covered have implications going beyond the payments industry and may not therefore be appropriately covered within a payments initiative. It is not clear,

for instance, how Annex 2, dealing with information requirements, would co-exist with the requirements of the Electronic Commerce Directive. Annex 18 dealing with data protection and Annex 19 dealing with digital signatures are other examples. The subject matter is of broader application than payments in both these latter cases and amendments as a result of this consultation process may necessitate amendments to the relevant EU and national legislation.

A number of undefined terms, such as “real bearer instrument”, “durable medium” and “payment service provider” are used within the paper. It is difficult to comment thoroughly on some aspects of the paper without a clear understanding of what, precisely, is intended to be covered by those terms.

#### Annex 1. Right to Provide Payment Service to the Public

We would be supportive of any initiative to harmonise the licensing of money transmission and remittance services within the EU (i.e. the second solution). As these types of service involve a lesser degree of regulatory risk than both e-money issuance and banking, it should be made clear that any authorised ELMI should be entitled to undertake money transmission within the scope of its e-money authorisation without any requirement for additional authorisation within the EU. The issue and circulation of e-money inevitably involves an element of money transmission in any event and does not give rise to additional risk.

We are concerned about the references to the definition of e-money and, in particular, to the specific reference to PayPal as being closer to a credit transfer within a centralised account system than a real bearer instrument. Regardless of whether an e-money system operates via smartcards (a bearer instrument) or the Internet, the fact remains that there is going to be some form of back end settlement system to apportion the redemption obligations of the participating issuers. This applies regardless of whether the system accounts for individual transactions. Mondex is commonly regarded as the closest e-money initiative to real cash circulating as a bearer instrument, but a legal analysis of that product can appropriately classify payments made from one card to another as representing credit transfers as the underlying redemption liability passes from one participating card/e-money issuer to another.

Accordingly, any distinction between products such as PayPal and systems that rely on so called bearer instruments is logically flawed. PPEL would be very concerned about any attempt to re-classify the nature of its service on the basis set out in the consultation paper.

We would also point out that the analysis on pages 22-3 does not appear correct in that the E-Money Directive does not define e-money in terms of monetary value circulating on a real bearer instrument.

It is essential that any proposed amendment to the current payments legal framework observes the principles of maintaining an even regulatory playing field and technological neutrality. It is noted that there is no reference to technological neutrality in the list of dash points on page 23 and assume this is an oversight.

It should be noted that the main technologies involved in providing e-money initiatives are converging (the Internet and mobile telephone networks). The Commission should note that exemptions applicable to one technology may produce absurdities where the same digital content has different legal implications depending on the delivery channel. Any exemptions applied to specific services perceived to be “without risk” (such as PRS services) should accordingly apply to any equivalent service provided via an Internet initiative. It is inaccurate to view any pre-payment service as being “without risk” as the issuer is, by definition, holding customer funds. The question is to quantify the risk and apply an appropriate level of regulatory and supervisory control commensurate with the risk involved. For these reasons, we are not supportive of the third solution.

The precise scope of any exemption granted (be it for PRS or any other initiative) must be clearly defined so as not to be open to any later abuse. In this respect, it must be noted that the development of 3G technology means that the provision of third party services via a mobile phone network is likely to increase considerably over the coming years and so the effect of any exemption perceived to have limited effect at the time of writing is likely to have much wider application within a few years unless very carefully worded.

We would urge that any amendments to the E-Money Directive await the review scheduled for April 2005.

#### Annex 2. Information Requirements

We support the need for transparency in relation to terms and conditions relating to a payment service.

However, it is not clear to us how the requirements set out in this annex relate to the provisions of the recently implemented E-Commerce Directive which provides for information relating to such matters as contract terms and pricing to be provided to the user of an e-commerce service. Insufficient time has lapsed since the implementation of that Directive to enable an assessment of whether additional requirements are necessary for reasons of transparency or otherwise.

We would strongly object to the introduction of any requirement to issue contracts or offers “on paper or another durable medium”. This could render many payment services, particularly those aimed at small payments, uneconomic. Customers of on-line services are now accustomed to the accepted manner of contracting on-line and are able to download or print a copy of any contractual terms that apply.

#### Annex 4. Value Dates

An e-money institution is not permitted to pay interest on an account balance nor grant credit, so the issue of the value date does not arise. It should be noted that, where e-money institutions rely on local clearing and card systems to credit or debit e-money, they cannot be responsible for the settlement cycles applied by such systems.

#### Annex 8. Information on the Originator of a Payment

Our understanding of SRVII is that it only applies where the payment in question is made from one payment service provider to another. It should be clarified that it does not apply on an intra group basis: that is where the payer and payee are customers of separate entities within the same group. Members of the same group of companies are clearly in a much better position to share and interpret data relating to potential terrorist activity.

It is our understanding that certain exemptions have been made for credit and debit card systems. Such exemptions should be available to e-money institutions on the basis that e-money is essentially a product to facilitate payments lower in value than those served by the credit and debit card market.

Confirmation is also sought that the “unique identifier” requirement referred to in paragraph 2 on page 41 is satisfied by an email address (which is unique). The complete list of requirements in paragraph 2 is onerous in the case of most retail payments and, in view of the personal data disclosed, would discourage many people from using on-line payment services.

#### Annex 9. Alternative Dispute Resolution

We assume that the Financial Ombudsman Service in the UK (which has jurisdiction, amongst other things, over complaints related to e-money payments) would satisfy the requirements.

#### Annex 10. Revocability of a Payment Order

E-money payments are usually instantaneous (or nearly instantaneous). It is not therefore material whether the payment order can be revoked on initiation, execution, account debit or receipt by the beneficiary since the opportunity to exercise any right of revocation during the payment process is severely limited.

E-Money systems, particularly those which are Internet based, are heavily reliant on underlying sources of funding used to purchase e-money (normally a bank account, credit or debit card). It is important to ensure, therefore, that the right to revoke a payment order relating to the funding source for e-money purchase or redemption is consistent with the revocation right applying to the e-money payment order itself.

It should never be the case that a customer can initiate a payment order for the purchase of e-money, and then initiate an e-money transaction only later to be able to revoke the original funding order. Any right of revocation must cease at the point of which other

parties involved in the transaction (be they PSPs or beneficiaries) take any action in reliance on the payment order.

In this respect we have some concern that the ability to revoke an on-line card funded transaction by relying on chargeback rights operated under credit card systems can work inequitably against e-money issuers in many instances.

Similarly, where an e-money device is loaded from a bank account the e-money is available for spending by the customer whereas the issuer may not have received value at that point from the bank (due to normal clearing cycles). The customer should not therefore be able to revoke the payment order given to the bank.

#### Annex 11. Role of PSP in Customer/Merchant Dispute in Distance Commerce

It should be remembered, in the case of e-money, that the product offerings are intended to represent a surrogate for notes and coins. There is clearly no responsibility on the part of the issuer (the relevant central bank) for any transaction funded by notes and coins. This is a good prima facie reason for not introducing such liability for e-money systems.

The introduction of some form of joint liability (along the lines of connected lender liability in the UK) would impose additional costs on service providers and possibly render some service offerings uneconomic.

PayPal has initiated buyer and seller protection programmes and money back guarantees<sup>1</sup> which provide protection for buyers and sellers provided they fulfill certain conditions. These have been introduced to facilitate confidence in e-commerce thereby generating business. This proves that protection can be provided by responsible service providers if left to market forces. Service providers should be free to determine which forms of protection (if any) are appropriate to provide their customers. The introduction of a standard set of binding rules may not be appropriate for all services.

#### Annex 12. Non-Execution or Defective Execution

Clearly, any PSP must execute a payment order in accordance with the customer mandate. Service providers should, however, be able to legitimately exclude consequential losses arising from the breach of mandate. In most instances, service providers will have no knowledge of the nature of the purpose of the payment and have no control over it. They should not therefore be exposed to consequential loss claims that could be entirely out of proportion to the fees charged for the payment service or the amount of the payment.

#### Annex 13. Unauthorised Transactions

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<sup>1</sup> These initiatives are not yet available to all EU based customers although coverage is expanding

Clear consumer protection provisions relating to use of a card in an on-line environment are set out in the Distance Selling Directive. It is not clear how these provisions would be affected.

Service providers need a reasonable period of time to investigate alleged fraudulent use and the reference to “without delay” in paragraph 3 at the foot of page 54 should be qualified accordingly.

#### Annex 15. Execution Time for Credit Transfers

The position of those service providers who depend on bank settlement and clearing cycles may require some clarification. In the case of PayPal, a transaction can be affected from one account to another almost instantaneously but withdrawal of the payment to a bank account will be subject to settlement cycles beyond PayPal’s control some of which may exceed three days.

#### Annex 19. Digital Signatures

The Directive on Electronic Signatures has been in force for less than three years and insufficient time has passed to properly assess its impact.

PKI is a complex and costly technology to implement and, notwithstanding its technical sophistication, as a means of identification and authentication, it is ultimately dependent on the quality of the process in place to link the individual to the public key. It is that process which will largely determine the weight of evidence to be attached to an allegation that a particular individual used a digital signature on a particular occasion. Also, a digital signature provides no protection against an allegation that the device holding the relevant key was not used by an unauthorized person. PKI has certainly not proved itself to be a viable solution for authentication in the B2C sector and it is unlikely that additional legislation would make any significant difference. The additional cost of such structures could render certain payment systems uneconomical.

#### Annex 20. Network Security

The suggested obligation to inform customers of security breaches allowing unauthorised access to customer data could lead to a lack of confidence in the service provider which in turn could have a potentially devastating impact on the business disproportionate to the security risk involved. It is not clear what this would achieve given that the immediately following proposal is that the customer should not be liable in any event.

It should also be noted that in the case of regulated financial institutions (such as PayPal), there are ongoing supervisory obligations to ensure that appropriate levels of security are in place. Therefore, any additional obligations should be confined to the non-regulated sector.

## Annex 21. Breakdown of a Payment Network

Most payment systems are to a certain extent reliant on interaction with networks operated outside their control and should be free to exclude any liability that could arise due to circumstances over which they have no direct control.

Breakdown of a system needs to be carefully distinguished between planned and unplanned downtime for maintenance and system enhancement which may be required by any system from time to time.

In the B2C sector, there are a large number of payment alternatives available and there is little risk in practice of a customer incurring real loss due to the temporary unavailability of a single system. On-line merchants rarely offer just one means of payment and customers rarely possess only a single means of payment. Accordingly there is little risk to the sensible user of a retail payment system and there is no need for any additional legislation in this area.

PayPal appreciates the opportunity to be involved in commenting on the Commission's initiative and would appreciate being involved in future consultation.

Yours faithfully

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Legal Director

