



Vodafone's comments to the Communication from the Commission to the Council and the European Parliament concerning a New Legal Framework for Payments in the Internal Market COM (2003) 718

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INTRODUCTION

Vodafone Services Ltd (hereafter 'Vodafone') welcomes the Commission Communication on a New Legal Framework for Payments in the Internal Market (hereafter 'the Communication'). Vodafone believes that there is an urgent need for reform. This consultation is of direct interest to Vodafone as it addresses two areas of risks:

1. Vodafone, and other mobile operators, are developing new services, some of which may be considered to be payment services and subject to new forms of regulation under the European payment regime. In doing so we are expanding the scope of our business. Mobile payment services are currently modest but growing, representing about 70,8 million transactions in 2002 in Europe¹. This compares with an overall non-cash payment market of 52,419 million transactions in the EU in 2001².
2. The scope of the existing European payment legislation may also be expanding to apply to services, which have long been provided by Vodafone under our existing scope of business. This is already very substantial: Vodafone has over 130 million proportionate customers and more than 327 million total customers³. The turnover of Vodafone is £16.9bn⁴.

EXISTING AND FUTURE SCOPE OF MOBILE OPERATOR ACTIVITIES

Vodafone customers can purchase telecommunications services either through their post-paid mobile phone bill or through a prepaid account. Traditionally, these services have included:

- person to person communications
- access to WAP and WEB sites
- premium rate services - being services where part of the revenue from the call, billed by Vodafone, is passed to a third party. (An example of a premium rate service is a directory enquiry service, where the information provided to a customer may be provided by a party other than Vodafone.)

¹ "Mobile Data 2004", Credit Suisse First Boston, European Wireless Telecommunications Services (15 September 2003)

² ECB – Blue Book – September 2003

³ By 31 December 2003. Source: Vodafone KPI announced on 28 January 2004.

⁴ Statutory highlights by H1 03/04. Source: Vodafone Group Plc Interim Announcement of 30 Sept. 2003.

Vodafone is also developing a micro-payment facility, to enable customers to charge small amounts to their phone bill or prepaid account. This will have the following advantages:

- It will stimulate the development of new digital content, which can be offered via the mobile, which is especially important to further exploit the benefit of 3G technology. Mobile payment services meet a demand for micro-payment, which some existing payment instruments (debit or credit cards, cheques...) are not addressing because it would not be economically viable to do so or it would add complexity to the transaction. Cash is of course the usual way to pay for small sums, but it is not practical for purchases at a distance, as applies to many digital goods and services.
- It will give customers an easy and efficient method of making micro-payments. Mobile payment services build upon existing mobile business, bringing thereby economies of scale and scope, which improves the economics of payment infrastructure models. Mobile payment services are complementary to mobile services and available to existing mobile users who do not need to acquire additional hardware or software to use them. They are available to a large customer base from day one: this critical mass increases their chance of success.
- It is available to customers with a poor credit status who are able to purchase prepaid phones but may be denied other payment instruments. Mobile payment services address a new customer segment of the payment market: they are accessible to a large number of users, as the penetration of mobile services is above 80% in Europe, still increasing and across all categories of the population. In addition, mobile take-up is specifically high in the youth and teenagers market, a category of consumers, who cannot make use of some payment instruments such as credit or debit cards.

In some countries, Vodafone has already launched a payment solution, but to date, these have been constrained by the E-Money Directive and related payments legislation. In the UK, Vodafone has launched a product called "m-pay bill" which enables the customer to charge small amounts to their phone bill or prepaid account: However, due to the fact that a waiver has been obtained under the E-Money Directive in order to offer this service, the overall amount stored on a customer prepaid account cannot exceed £90. Should that occur, the customer is barred from using "m-pay bill"⁵. In Germany, a similar product has been launched. It is however restricted to payments of less than €102, and - more important - there are significant restrictions on advertising of the product. In Ireland and the Netherlands, payment solutions have been offered to certain customers.

Experience to date shows that key requirements if these services are really to succeed and realise their full potential, are that 1) the customer should be able to pay for goods and services using their existing phone account, 2) we can exploit synergies between our existing and new business models and 3) barriers to adoption are kept as low as possible. We look to the New Legal Framework to achieve these objectives.

⁵ More details on "m-pay bill" can be found on www.vodafone.co.uk, section "m-pay shopping".

CORE PRINCIPLES TO ANY NEW LEGAL FRAMEWORK FOR PAYMENT

1. Proportional to the risk

The underlying objective of the review of the existing legal framework is the modernization and simplification of the regulatory framework applying to retail payment services in the Internal Market. Vodafone supports this objective. We welcome the reference in the Communication to the importance and need ‘to avoid over-regulation’. We also support the reference to co- and self-regulation and the possibility for market players to be proactive. However, the critical test is the ‘proportionality’ of regulation. Proportionality means that regulation, should not be tied to a service per se, but to risks associated with that service. Mobile payment services – as will be detailed below – give rise to modest risks.

Generally, two types of risks on the payment services market are mentioned: 1) a risk of financial instability of the overall system and 2) a risk on the consumer (to forfeit the value held by the issuer). This review addresses all types of payment services, both high and low risk in nature. This diversity must be recognised when requirements (information, security and others specified in the annexes) are devised. The same requirements cannot be imposed in the same way to services giving rise to different levels of risk.

A key determinant of risk is the competitiveness of the market. If there is competition and customers can easily switch between service providers, s/he will be exposed to lesser risk than if they are captive to monopoly suppliers or face high switching costs.

2. Cost of implementation

In our view the creation of a New Legal Framework for Payment consists in balancing the compliance costs born by customers and payment providers, against the risks such services create. Disproportionate regulatory requirements may impact on the cost or structure of the service, and may constitute an obstacle to adoption or development of that service. High compliance costs may discourage service providers from developing and offering new services at all. This would be a perverse outcome.

3. Technology neutrality

Technology neutrality is important and we are in favour of a framework that would apply in the same way to all players providing the same services and creating the same risks. We do not seek any ‘special exemption’ for mobile.

Vodafone also supports the Commission's stated intention to address legal deficiencies in the current legislation and to take account of market and technological developments. Vodafone is supportive of these objectives; in particular, our experience with the E-Money Directive and its current implementation constitute one of the main reasons for our involvement in this review. The market and technological developments have been such that elements of the existing framework (e.g. the E-Money Directive) are no longer appropriate – see below for more details.

APPLICATION TO MOBILE

1. Mobile payment services represent low risk

○ Security is high

Mobile networks are secure. Security is an underlying requirement of Vodafone's business as GSM technology is based on the use of algorithms and mobile communications are encoded. Mobile technology can be used for identification and authentication services as well as the use of electronic signatures. This increases security of transactions, including of payments, whether performed or facilitated by the mobile operator. Customer data is stored on our network, and not on the device, which provides a security in case for instance of loss/theft of the device.

Existing legislation already regulates mobile operators. As an electronic communication provider, we are regulated under the Electronic Communication Data Protection Directive (2002/58/EC), which imposes a number of obligations with regard to security - especially in its article 4 - and to related issues such as confidentiality of communications – article 5.

As noted in the Communication, it is important to strike a balance between security on the one hand, and customer usability and economic viability on the other. Security measures must be proportionate to the risk incurred. Obligations to address money laundering, for example, only make sense if there is a real threat of use of those services to launder money. In the case of mobile payment services, used only for micro-payments, this is improbable – see more detailed comments of Annex 8.

○ Mobile is competitive

The competitiveness of the mobile industry means that consumer risks are limited. Security and reliability is a competitive tool. As provider of mobile communications services, which are considered as highly personal, Vodafone has put an emphasis on designing services with a simple user interface, providing an easy customer experience. Customers in our industry do switch between providers at minimal costs. Churn rates are very high in the mobile communications sector (see comments on annex 6).

2. Cost of regulation can be substantial for mobile

The cost of regulation of mobile payments can be substantial and impact on competition as well as on existing customers registration and management. Mobile operators are providing mobile payment services as an ancillary service to their main business. Mobile payment services are delivered on existing systems and designed to exploit synergies with existing platforms.

Any requirement to redesign significantly these models – for instance by means of identification of customers, or by creating a separate entity, or by restructuring lines of business may make the payment service uneconomic. If compliance costs are too high, the development of efficient new innovative payment services may be frustrated altogether. Our objective must be for both to minimise risk and minimise cost.

3. Vodafone supports technology neutrality

Players should be regulated according to the risk their activities put on the overall system for payments. There may therefore be different rules for different players, not based on the technology used, but on the type of service they offer. This reflects again the principle of proportionality.

The current E-money Directive does not take into account the fact that some providers of e-money may actually run as principal business, which is quite unrelated to e-money issuance. This is the case for Vodafone. Complying with the E-money Directive puts additional costs on these multi-purpose businesses. Our views as to how these conclusions can be embodied in a revised E-money Directive appear at Appendix A.

COMMENTS ON ANNEXES

Below you will find detailed comments on the analysis and proposals made in the annexes. We are not commenting on some annexes, which are not relevant in any way to our business (Annex 3: non-resident accounts, Annex 4: value dates, Annex 5: portability of bank account numbers, Annex 14: the use of 'our', 'ben', 'share', Annex 15: execution time for credit transfers, Annex 16: credit debiting, Annex 17: removing barriers to cash circulation).

- **Annex 1 – Right to provide payment services to the public**

As indicated above, Vodafone welcomes this opportunity to review the current licensing regime for payment services, and in particular, reform of the E-Money Directive. As we have had the opportunity to highlight to the Commission on several occasions during the last year, the existing E-Money Directive raises a number of issues. The two main issues are as follows:

- Its scope is not clear enough. There are a number of different views on what is regulated by the E-Money Directive, which has led to differing interpretations and implementations of this Directive throughout Europe.
- The Directive does not recognise the existence of multi-purpose instruments. It failed to anticipate the new types of payment services, which would develop, in particular, multi-purpose accounts, and instead specifically restricted this type of service.

As a consequence the current regime puts a disproportionate burden on undertakings – such as Vodafone. Not only does it hinder our development of new payment services but it also impacts our existing mobile communications business. While it was designed to promote innovation and encourage new players to enter the market for payment services, it has failed to achieve those objectives. As the Commission mentions, the number of new payment services based on an e-money licence in Europe has not reached ten, and some licences were granted to bank subsidiaries.

We strongly welcome the Commission's proposal to reform this Directive and would like this to take place as soon as possible, if possible detached from this package and in any case ahead of the planned review mentioned in the Directive itself (2005). We also advise that this review takes into account the elements of analysis and proposals, which will come out of the Commission's Communication on the E-money Directive due at the end of 1Q 2004. Our main objective is to ensure that the solution is simple, straightforward and fast; the uncertainty, which currently exists throughout Europe is causing irreparable harm to the development of new services.

Our preferred solution is to amend the E-Money Directive in order 1) to recognise different categories of risk, 2) to take account of multi-purpose providers and 3) to extend the waivers to exclude areas of minimal risk. Regulation should seek to address risks (as detailed above) and not to 'cover' all existing services without considering whether or not they give rise to risk. Should a new type of license be introduced, it would need to also take this into account. In conjunction with this, the money laundering legislation will also need to be amended to apply to low risk services, in a proportionate and sensible way.

Vodafone understands the need to apply a minimum of regulation on payment services. We do not question the requirement that payment service providers hold a license per se. Our concern is related to the scope of the license and then to the conditions attached to such a license. It is important that the principle of proportionality applies to any new rules coming out of this review. We mention in a separate appendix the elements to take into account in a review of the current E-money Directive.

In any case, we support the reference to the four principles enumerated by the Commission on page 23 of the Communication and we welcome the addition of a reference to the 'level playing field' compared with the last working document version of this consultation.

Finally, the views mentioned in the Communication according to which 'credit institution' licenses could be necessary for post-paid services provided by mobile operators should bear in mind that such activities are already regulated by credit laws, which take account of the very different risk profile which applies to such amounts. The requirement of a credit institution license for pre-paid mobile services would be disproportionate.

- **Annex 2 – Information requirements**

As detailed above, Vodafone has extensive experience with the retail market and understands the importance of the provision of information to customers. Nevertheless we are also aware of the fact that too much information is negative. The right timing and the right medium are important and are not necessarily the same for all customers. Flexibility being required, we wonder whether binding legislation is the appropriate tool. The provision of information can also be an element of competition.

The principle of proportionality should in any case apply to this obligation. We welcome the mention in the Communication of the fact that 'some specific provisions applicable only to certain payment services, such as credit transfers or micro-payments, may need to be

considered'. We regret however not to see any mention of it in the very first draft provisions contained in Annex 2, as some of the information requirements seem particularly onerous and will be difficult to implement in practice with this type of product. We would suggest that instead, additional requirements should apply if certain key information is not provided e.g. if the customer is to be responsible for misuse/theft of their micro-payment account, they must be told in advance, or will not be responsible.

In addition, it should be remembered that much of the information specified in Annex 2 is already required to be provided under the Distance Selling Directive and the Electronic Commerce Directive.

- **Annex 6 – Customer Mobility**

The issue of customer mobility is very much linked to bank accounts and of little relevance to micro-payments and mobile payment services. However, it may be relevant to state here that mobile customers are able to change mobile communications service provider as they see fit and to take their mobile numbers with them. Churn is high in the mobile industry, and above 21% on average for Vodafone⁶.

- **Annex 7 – The evaluation of the security of payment instruments and component**

Vodafone's experience from the electronic communications sector tells that standardisation is best achieved when led by the industry. We also recommend that this be led by those bodies that are developing a de-facto standard, such as Simpay for the mobile payment services area, rather than standardisation bodies per se. Simpay – of which Vodafone is a founder - has been created to facilitate the development and availability of new mobile payment services. It intends to publish the security requirements for its scheme for both the mobile payment issuer side and the merchant acquiring side⁷.

- **Annex 8 – Information on the origination of a payment (SRVII of FATF)**

After the issue of market access and licensing, the question of identification of the origination of a payment is the second most important of this review for Vodafone.

Our reason to resist the implementation of identification measures comes from the unlikelihood of our mobile payment services being used to launder money. The services provided will be micro-payments and the sums therefore small. Currently, the average mobile payment transaction is at about €2. The idea of a *de minimis* threshold is not foreign to money laundering rules. Our view is therefore to introduce such a threshold (per

⁶ Total figure (post- and pre-paid) by H1 03/04. Source: Vodafone Group Plc Interim Announcement of 30 September 2003.

⁷ More details about SIMPAY can be obtained on: www.simpay.com.

account) and we support the proposal of the Commission (article 3 on page 41). It should also be recalled that today, our mobile services are not redeemable. So there is no possibility on the customer side, to launder money. A risk can exist, although limited, on the merchant side however. We suggest that this is addressed by setting up checks on merchants and their identity.

We are also keen to see that exemptions from the application of the E-Money Directive also cover money laundering applications (knowing that such exemptions would be granted on the basis of a limited risk).

Fulfilling money-laundering obligations is very burdensome for operators. They put a high cost on a low risk. Our pre-paid users (a vast majority of our customers, from 34% in Sweden to 92% in Italy)⁸ are not always identified. Countries such as the UK, Ireland, Spain, Belgium Netherlands and Greece do not require identification and pre-paid customers remain therefore anonymous. This possibility is very popular. Having to identify all these customers would therefore be very costly relatively to the risk addressed. Other countries, such as France, Germany, Italy require a customer identification, but the elements of identity requested are not sufficient to meet the money laundering requirements. Upgrading the identification process and implementing it on the existing customer base would be cumbersome.

- **Annex 9 – Alternative Dispute Resolution**

Vodafone would recommend that ADR is not introduced in respect of micro-payment solutions as we are already providing dispute resolution mechanisms to our customers. Again, micro payment services are used for small amount payments and are therefore only an ancillary part of our business. A new ADR system would add considerable cost to the running of a micro-payment scheme which is not justified by the benefits. This area should be kept under review and ADR should only be implemented in respect of micro-payment solutions if existing arrangements are demonstratively inadequate.

- **Annex 10 – Revocability of a payment order**

We support the 5th option, which does not allow for the revocability of a payment once it has been given to the Payment Service Provider. The handling of revocability of micro-payments would indeed be costly and not very efficient.

Revocability of a payment should not be accepted for goods or services delivered/consumed immediately after the payment is sent. This is the case for digital content delivered over the phone.

⁸ By 31 December 2003. Source: Vodafone KPI announced on 28 January 2004.

- **Annex 11 – The role of a payment service provider in the case of a customer/merchant dispute in distance commerce**

Charge-backs or joint liability of a payment service provider is not appropriate in relation to micro-payments. Micro-payments will predominantly be used by consumers, who have redress already against merchants; they have the right to take legal action in their own country and benefit from consumer protection laws, including the information requirements imposed on merchants. Contacting the merchant to arrange a refund should not be an issue. The mobile payment issuer can of course always decide - at its own discretion - to re-credit a customer's account in response to a customer complaint.

- **Annex 12 – Non-execution or defective execution**

The idea of adopting rules to regulate the liability of the Payment Service Provider in case of non-execution or defective execution of a payment order seem sensible and reasonable. However, care should be taken when applying these principles to micro-payment account based products to ensure that they apply proportionately.

- **Annex 13 – Obligations and liabilities of the contractual parties related to unauthorised transactions**

Currently, if a phone is lost or stolen, a customer can report it and the SIM card is immediately deactivated. The customer will not be responsible for any losses arising after the report is made by the customer - the same principle will apply to payment services offered in connection with that account.

- **Annex 18 – Data protection issues**

As an electronic communication provider, Vodafone is subject to both Directives on Data Protection (1995/46/EC and 2002/58/EC). We are also familiar with the conflict between fraud prevention and data protection and welcome any attempt to bring clarity and legal certainty.

Out of the four options presented in the Communication, Vodafone support a combination of 1) Guidelines for the short term, together with the Article 29 Working Party; and 2) Improvement of the implementation process, which will also be helpful in relation to Security (Annex 20).

- **Annex 19 – Digital signatures**

The Communication details accurately the reasons for the lack of availability and usage of electronic signatures. The main one is the implementation of the existing Electronic

Signature Directive, which is flawed. The Directive imposes the predominance of the 'Advanced Electronic Signature' over other types of – simpler – electronic signature, which are therefore not getting recognition.

Vodafone supports a review of the implementation of this Directive in order to enable the usage of electronic signature to really take off and suggests that the Commission, in the framework of this review on payments, presses for a thorough review in the near term.

- **Annex 20 – Security of the networks**

The matter of network security is important as demonstrated by the recent increase of regulation around it.

The option to introduce additional data protection rules in the New Legal Framework for Payment, should be rejected. The problem is less the existence of rules than the lack of implementation and of enforcement, as rightly pointed out in the Communication. We therefore suggest that the Commission works with Member States on the improvement of the implementation of the Data Protection Directive.

The proposal for work items to be covered by the ENISA, such as data collection and expert advice would fall in its scope and should be pursued. The role of facilitating the conclusion of agreements on security level goes on the other hand well beyond it. As the ENISA is not operational yet, it is too early to evaluate the impact it may have.

- **Annex 21 – Breakdown of a payment network**

Introducing regulation on the liability of the Payment Service Provider in case of breakdown or non-availability of its network does not seem feasible. The practicality of such an implementation, as rightly described in the consultation, would be cumbersome (burden of proof, evaluation of damages).

In competitive markets, it is in all Payment Service Providers commercial interest to avoid such casualties and provide full availability of its service. Each provider should decide on its quality of service policy towards its customers.

APPENDIX – POINTS OF THE CURRENT E-MONEY DIRECTIVE TO BE REVIEWED

- The **scope of the license** related to payment services should be clear and detailed enough to avoid diverging interpretations at national level:
 - the current definition (e-money Directive article 3.b) should at least be amended, if not completely reviewed. A fundamental review of the definition of e-money may be needed, as suggested by the observed gap between the reference to a real bearer instrument in the Communication and the reality of the market;
 - adding a set of criteria, a non-exhaustive list, to be used to determine whether some activities fall under the scope of the Directive, could bring clarity.
- The case of **multipurpose payment means** should be clearly recognised and addressed. The primary use of a mobile phone will be the use of our own services, such as person to person communications. These are specific purposes. However, an ancillary use may be the purchase of other services, such as buying cinema tickets or ordering a book on the Internet - provided that a merchant accepts it as a means of payment. This is a general purpose.
 - In that context a **mechanism to separate** the amounts regulated and those not regulated should be set-up. Otherwise the impact of regulation would be disproportionate. Such a separation should be done at the accounting level (ex-post) in order to allow the issuer flexibility to design its service.
 - Such multipurpose payment schemes should benefit from an exemption to any **redeemability obligation**. Instead, the customer will be able to use any prepaid amounts for the issuer's own services.
 - Due consideration should be given to the fact that a multi-purpose scheme issuer, by definition, runs other activities/business. Therefore the **restriction of activities** (e-money Directive article 5) should not apply. It otherwise destroys synergies.
 - It is important that licenses, but also any waivers and/or exemptions can be **passported** throughout the Internal Market. The current Directive does not currently allow for waivers to be passported.
- To allow for flexibility, a number of **thresholds and exemptions** clearly specified should be included in the new Directive:
 - the current waivers (article 8) should be secured;
 - some new *de minimis* rules should be introduced so that micro-payment services are exempted from certain obligations (i.e. redeemability, money laundering), on the basis of the low risk they incur.