|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Title:  Impact Assessment on draft E-Money Regulations  Lead department or agency:  HM Treasury  Other departments or agencies: | |  | | --- | | Impact Assessment (IA) | | IA No: | | Date: 14/09/2010 | | Stage: Consultation | | Source of intervention: | | Type of measure: | | Contact for enquiries:  Faizan Jabbar | |

# Summary: Intervention and Options

|  |
| --- |
| What is the problem under consideration? Why is government intervention necessary?  A review of the European regulatory framework for issuers of electronic money found that the e-money market was developing more slowly than expected. The main causes were found to be uncertainty over the application of the rules to new business models, tight prudential requirements and inconsistent application of the rules by Member States.  A new Electronic Money Directive to update the rules was adopted in September 2009 (2009/110/EC). Implementing Regulations will take effect on 30 April 2011. |

|  |
| --- |
| What are the policy objectives and the intended effects?  There are three objectives, to:  • reflect technological changes, and promote innovation in the design of new, secure e-money products;  • reduce barriers to entry and increase competition in the market; and  • modernise the rules for e-money issuers and align them with existing rules for payment service providers.  The new framework introduces a lighter prudential regime for e-money issuers who are not banks, and new safeguarding and refund rules protect customers. For example, it lowers the initial capital requirements, allows issuers to undertake a wide range of mixed business activities, and waives some rules for small firms |

|  |
| --- |
| What policy options have been considered? Please justify preferred option (further details in Evidence Base)  The options are  Option 1: Exercise some, but not all, of a number of optional waivers, notably to reduce or disapply the requirements for small firms, and to reduce some potential negative impacts of new safeguarding and redemption requirements for customers’ funds.  Option 2: Implement the Directive without any cost mitigating measures.  Both options are estimated to generate net benefits. The preferred option is Option 1 because it applies a more proportionate, lower cost regime while maintaining consumer protection. |

|  |  |
| --- | --- |
| When will the policy be reviewed to establish its impact and the extent to which the policy objectives have been achieved? | It  be reviewed  11/2012 |
| Are there arrangements in place that will allow a systematic collection of monitoring information for future policy review? |  |

Sign-off For consultation stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible : Date:

# Summary: Analysis and Evidence Policy Option 1

Description:

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Price Base Year 2010 | PV Base Year 2010 | Time Period Years 10 | Net Benefit (Present Value (PV)) (£m) | | |
| Low: Optional | High: Optional | Best Estimate: £15m |

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| COSTS (£m) | Total Transition   (Constant Price) Years | | Average Annual  (excl. Transition) (Constant Price) | Total Cost  (Present Value) | |
| Low | Optional | 10 | Optional | **Optional** | |
| High | Optional | Optional | **Optional** | |
| Best Estimate | 3 | 4 | **7** | |
| Description and scale of key monetised costs by ‘main affected groups’  The key monetised costs relate to new requirements for safeguarding and redeeming customers' funds, and proposed new minimum capital requirements for small issuers who were previously exempt from holding a minimum level of capital. The precise level of capital required is being consulted on. | | | | | |
| Other key non-monetised costs by ‘main affected groups’  None | | | | | |
| BENEFITS (£m) | Total Transition   (Constant Price) Years | | Average Annual  (excl. Transition) (Constant Price) | Total Benefit  (Present Value) | |
| Low | Optional | 10 | Optional | **Optional** | |
| High | Optional | Optional | **Optional** | |
| Best Estimate | 7 | 15 | **22** | |
| Description and scale of key monetised benefits by ‘main affected groups’  Many firms will benefit from lower capital requirements as compared to the existing regime. This will generate one-off transitional benefits for existing firms, and lower on-going capital costs, as well as lower costs for new entrants to the market in future | | | | | |
| Other key non-monetised benefits by ‘main affected groups’  The new rules will help to promote innovation and competition in the e-money market. New entrants to the market will be able to take advantage of lower prudential requirements and a more proportionate regulatory regime that is aligned with the exising regime for payment service providers. Consumers will benefit from the clarification of their rights to redeem funds at par value and at any moment, and from secure arrangements for protecting their funds from the insolvency of an e-money issuer | | | | | |
| Key assumptions/sensitivities/risks Discount rate (%) | | | | | 3.5 |
| This assessment makes conservative assumptions about:  (i) the number of potential new entrants to the market, based on current entry rates;  (ii) the average capital maintained by small issuers at present, based on their level of business;  (iii) authorisation and registration fees, based on current FSA scales for payment service providers. | | | | | |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Impact on admin burden (AB) (£m): | | | Impact on policy cost savings (£m): | In scope |
| New AB: | AB savings: | Net: | Policy cost savings: |  |

# Enforcement, Implementation and Wider Impacts

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| What is the geographic coverage of the policy/option? | | |  | | | | |
| From what date will the policy be implemented? | | | 30/04/2011 | | | | |
| Which organisation(s) will enforce the policy? | | | FSA | | | | |
| What is the annual change in enforcement cost (£m)? | | | Not set yet | | | | |
| Does enforcement comply with Hampton principles? | | |  | | | | |
| Does implementation go beyond minimum EU requirements? | | |  | | | | |
| What is the CO2 equivalent change in greenhouse gas emissions?  (Million tonnes CO2 equivalent) | | | Traded:  N/A | | Non-traded: N/A | | |
| Does the proposal have an impact on competition? | | |  | | | | |
| What proportion (%) of Total PV costs/benefits is directly attributable to primary legislation, if applicable? | | | **Costs:**  N/A | | | **Benefits:** N/A | |
| Annual cost (£m) per organisation (excl. Transition) (Constant Price) | Micro | < 20 | Small | Medium | | | Large |
| Are any of these organisations exempt? |  |  |  |  | | |  |

# Specific Impact Tests: Checklist

Set out in the table below where information on any SITs undertaken as part of the analysis of the policy options can be found in the evidence base. For guidance on how to complete each test, double-click on the link for the guidance provided by the relevant department.

Please note this checklist is not intended to list each and every statutory consideration that departments should take into account when deciding which policy option to follow. It is the responsibility of departments to make sure that their duties are complied with.

|  |  |  |
| --- | --- | --- |
| Does your policy option/proposal have an impact on…? | Impact | Page ref within IA |
| Statutory equality duties[[1]](#footnote-1) |  | N/A |

|  |  |  |
| --- | --- | --- |
| Economic impacts |  | |
| Competition |  | Yes |
| Small firms |  | Yes |

|  |  |  |
| --- | --- | --- |
| Environmental impacts |  | |
| Greenhouse gas assessment |  | N/A |
| Wider environmental issues |  | N/A |

|  |  |  |
| --- | --- | --- |
| Social impacts |  |  |
| Health and well-being |  | N/A |
| Human rights |  | N/A |
| Justice system |  | N/A |
| Rural proofing |  | N/A |

|  |  |  |
| --- | --- | --- |
| Sustainable development |  | N/A |

# Summary: Analysis and Evidence Policy Option 2

Description:

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Price Base Year 2010 | PV Base Year 2010 | Time Period Years 10 | Net Benefit (Present Value (PV)) (£m) | | |
| Low: Optional | High: Optional | Best Estimate: £14m |

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| COSTS (£m) | Total Transition   (Constant Price) Years | | Average Annual  (excl. Transition) (Constant Price) | Total Cost  (Present Value) | |
| Low | Optional | 10 | Optional | **Optional** | |
| High | Optional | Optional | **Optional** | |
| Best Estimate | 4 | 4 | **8** | |
| Description and scale of key monetised costs by ‘main affected groups’  The key monetised costs relate to new requirements for safeguarding and redeeming customers' funds, and new minimum capital requirements for small issuers who were previously exempt from holding a minimum level of capital. The principal cost element is the minimum capital requirement, which is higher than in option 1. | | | | | |
| Other key non-monetised costs by ‘main affected groups’  None | | | | | |
| BENEFITS (£m) | Total Transition   (Constant Price) Years | | Average Annual  (excl. Transition) (Constant Price) | Total Benefit  (Present Value) | |
| Low | Optional | 10 | Optional | **Optional** | |
| High | Optional | Optional | **Optional** | |
| Best Estimate | 7 | 15 | **22** | |
| Description and scale of key monetised benefits by ‘main affected groups’  Many firms will benefit from lower capital requirements as compared to the existing regime. This will generate one-off transitional benefits for existing firms, and lower on-going capital costs, as well as lower costs for new entrants to the market in future. | | | | | |
| Other key non-monetised benefits by ‘main affected groups’  The new rules will help to promote innovation and competition in the e-money market. New entrants to the market will be able to take advantage of lower prudential requirements and a a more proportionate regulatory regime that is aligned with the exising regime for payment service providers. Consumers will benefit from the clarification of their rights to redeem funds at par value and at any moment, and from secure arrangements for protectingng their funds from the insolvency of an e-money issuer | | | | | |
| Key assumptions/sensitivities/risks Discount rate (%) | | | | | 3.5 |
| This assessment makes conservative assumptions about:  (i) the number of potential new entrants to the market, based on current entry rates;  (ii) the average capital mainatained by small issuers at present, based on their level of business;  (iii) authorisation and registration fees, based on current FSA scales for payment service providers. | | | | | |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Impact on admin burden (AB) (£m): | | | Impact on policy cost savings (£m): | In scope |
| New AB: | AB savings: | Net: | Policy cost savings: |  |

# Enforcement, Implementation and Wider Impacts

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| What is the geographic coverage of the policy/option? | | |  | | | | |
| From what date will the policy be implemented? | | | 30/04/2011 | | | | |
| Which organisation(s) will enforce the policy? | | | FSA | | | | |
| What is the annual change in enforcement cost (£m)? | | | Not yet set | | | | |
| Does enforcement comply with Hampton principles? | | |  | | | | |
| Does implementation go beyond minimum EU requirements? | | |  | | | | |
| What is the CO2 equivalent change in greenhouse gas emissions?  (Million tonnes CO2 equivalent) | | | Traded:  N/A | | Non-traded: N/A | | |
| Does the proposal have an impact on competition? | | |  | | | | |
| What proportion (%) of Total PV costs/benefits is directly attributable to primary legislation, if applicable? | | | **Costs:**  N/A | | | **Benefits:** N/A | |
| Annual cost (£m) per organisation (excl. Transition) (Constant Price) | Micro | < 20 | Small | Medium | | | Large |
| Are any of these organisations exempt? |  |  |  |  | | |  |

# Specific Impact Tests: Checklist

Set out in the table below where information on any SITs undertaken as part of the analysis of the policy options can be found in the evidence base. For guidance on how to complete each test, double-click on the link for the guidance provided by the relevant department.

Please note this checklist is not intended to list each and every statutory consideration that departments should take into account when deciding which policy option to follow. It is the responsibility of departments to make sure that their duties are complied with.

|  |  |  |
| --- | --- | --- |
| Does your policy option/proposal have an impact on…? | Impact | Page ref within IA |
| Statutory equality duties[[2]](#footnote-2) |  | N/A |

|  |  |  |
| --- | --- | --- |
| Economic impacts |  | |
| Competition |  | Yes |
| Small firms |  | Yes |

|  |  |  |
| --- | --- | --- |
| Environmental impacts |  | |
| Greenhouse gas assessment |  | N/A |
| Wider environmental issues |  | N/A |

|  |  |  |
| --- | --- | --- |
| Social impacts |  |  |
| Health and well-being |  | N/A |
| Human rights |  | N/A |
| Justice system |  | N/A |
| Rural proofing |  | N/A |

|  |  |  |
| --- | --- | --- |
| Sustainable development |  | N/A |

# Evidence Base (for summary sheets) – Notes

Use this space to set out the relevant references, evidence, analysis and detailed narrativefrom which you have generated your policy options or proposal. Please fill in **References** section.

References

Include the links to relevant legislation and publications, such as public impact assessment of earlier stages (e.g. Consultation, Final, Enactment).

|  |  |
| --- | --- |
| No. | Legislation or publication |
|  | Directive 2009/110/EC on the taking-up, pursuit and prudential regulation of the business of electronic money institutions amending Directives 2005/6-/EC and 2006/48/EC and repealing Directive 2000/46/EC. |
|  | Directive 2000/46/EC of the European Parliament and the Council on the taking up and prudential supervision of the business of electronic money institutions. |
|  | Revisions to the EMD and implementing the EU regulation on cross border payments: a summary of consultation responses. HM Treasury. June 2009. |
|  | Staff Working Document accompanying the proposal for a Directive amending Directive 2000/26/EC.SEC(2008)2573. 9 October 2008. |

+

Evidence Base

Ensure that the information in this section provides clear evidence of the information provided in the summary pages of this form (recommended maximum of 30 pages). Complete the **Annual profile of monetised costs and benefits** (transition and recurring) below over the life of the preferred policy (use the spreadsheet attached if the period is longer than 10 years).

The spreadsheet also contains an emission changes table that you will need to fill in if your measure has an impact on greenhouse gas emissions.

Annual profile of monetised costs and benefits\* - (£m) constant prices

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | Y0 | Y1 | Y2 | Y3 | Y4 | Y5 | Y6 | Y7 | Y8 | Y9 |
| Transition costs | 3 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Annual recurring cost | 0.45 | 0.43 | 0.42 | 0.41 | 0.39 | 0.38 | 0.37 | 0.35 | 0.34 | 0.33 |
| Total annual costs | 0.45 | 0.43 | 0.42 | 0.41 | 0.39 | 0.38 | 0.37 | 0.35 | 0.34 | 0.33 |
| Transition benefits | 7.2 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Annual recurring benefits | 1.7 | 1.64 | 1.59 | 1.53 | 1.48 | 1.43 | 1.38 | 1.34 | 1.29 | 1.25 |
| Total annual benefits | 8.9 | 1.64 | 1.59 | 1.53 | 1.48 | 1.43 | 1.38 | 1.34 | 1.29 | 1.25 |

\* For non-monetised benefits please see summary pages and main evidence base section

# Evidence Base (for summary sheets)

A review of the European regulatory framework for issuers of electronic money found that the e-money market was developing more slowly than expected. The main causes were found to be uncertainty over the application of the rules to new business models, tight prudential requirements and inconsistent application of the rules by Member States.

A new Electronic Money Directive to update the rules was adopted in September 2009 (2009/110/EC). Implementing Regulations will take effect on 30 April 2011.

**Policy Objective**

There are three objectives, to:

• reflect technological changes, and promote innovation in the design of new, secure e-money products;

• reduce barriers to entry and increase competition in the market; and

• modernise the rules for e-money issuers and align them with existing rules for payment service providers.

The new framework introduces a lighter prudential regime for e-money issuers who are not banks, and new safeguarding and refund rules protect customers. For example, it lowers the initial capital requirements, allows issuers to undertake a wide range of mixed business activities, and waives some rules for small firms

**Description of options considered**

The options are

Option 1: Exercise some, but not all, of a number of optional waivers from the Directive requirements, notably to reduce or disapply the requirements for small firms, and to reduce some potential negative impacts of new safeguarding and redemption requirements for customers’ funds.

Option 2: Implement the Directive without any cost mitigating measures.

The preferred option is option 1, because it applies a more proportionate, lower cost regime while maintaining consumer protection.

The baseline for the assessment of these options has been normalised at zero in order to facilitate comparison between options 1 and 2.

**Option 1- Exercise a number of optional waivers**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Breakdown of costs and benefits** | | | | | |
| **Summary of key changes** | **Potential impacts** | | **Potential benefits** | | |
|  | Transitional | On-going | Transitional | On-going | |
| New definition of e-money | £0 | £0 | Qualitative | | |
| Prudential requirements | £1.4m- £2.4m | £0.04 - £0.12m | £5.4m-£9m | £0.4m - £1.2m | |
| Cost of capital |  | £0.25m |  | £0.9m | |
| New permitted activities | £0 | £0 | Qualitative | | |
| Exemption for limited networks | £0 | £0 | Qualitative | | |
| Safeguarding e-money | £0.8m-£1.4m | £0.1m-£0.4m | Qualitative | | |
| Redemption requirements |
| Storage limits | £0 | £0 | Qualitative | | |
| Waivers for small firms | £0 | £0 | Qualitative | | |
| New authorisation requirements | £0.04m | £0 | Qualitative | | |
| **Total** | £2.2m- £3.8m | £0.4m-£0.5m | £5.4-£9m | | £1.3m - £2.1m |

# Transition costs

Detail

1. There are three main sources of transition costs to firms:
   1. New minimum capital requirements for existing small issuers;
   2. New arrangements for redeeming and safeguarding customer funds;
   3. Potentially, existing issuers may incur additional authorisation fees.
2. Minimum capital requirements for small issuers

Small e-money issuers are defined in the directive as those whose total business activities generate an average outstanding electronic money of no more than €5 million. There are an estimated 48 small active issuers out of 78 registered small issuers in the UK. This assessment excludes 30 dormant firms. The dormant firms will not be affected by the new rules. They are not trading and are expected to drop out of the FSA’s register.

The capital requirements for small issuers are, at present, waived by the FSA. The FSA assess that issuers are holding a minimum level of capital in order to operate. This impact assessment makes a conservative assumption that small issuers are on average holding at least £25,000 of capital. This number is based on taking 4% of their reported outstanding liabilities, which average £625,000.

It would be possible to continue to set no capital requirement for small issuers, as now. This is considered risky, given the new freedoms that small issuers will enjoy, and the experience of failures of payment service providers and of retailers that have issued prepaid cards. It is therefore proposed to set a proportionate, minimum initial capital requirement of €75,000 (£65,000) for small issuers in future. The FSA will be able to vary the capital requirement by +/-20% according to the circumstances of each issuer. Small issuers will therefore be required to hold more capital than they are estimated to hold at present. The precise number is being consulted on.

The difference between the current estimated average capital being held (£25,000) and the proposed new requirement (£65,000) represents the additional capital that may (subject to the consultation) be required per small issuer.

The additional capital is:

New capital requirement per issuer £65,000

Average capital being held by issuers - £25,000

Additional capital per issuer £40,000

The **transitional capital requirement for small issuers** is estimated to be:

48 x £40,000 = £1,920,000

The projected range (+/- 25%) is between £1.4 million and £2.4 million

1. Redeeming and safeguarding customer funds

The main transition costs to firms will be in issuing new terms and conditions, and making new administrative arrangements. These relate to redeeming and safeguarding customer funds, with associated compliance costs. Some firms may also need to renegotiate contracts with their programme managers.

It would be possible to disapply this requirement for small issuers. It is not proposed to do so for the risk-based reasons set out in the section on capital requirements above, and in order to mandate best practice in safeguarding customers’ funds, and raise the quality of e-money in the UK.

Based on discussions with firms and industry representatives, the average direct costs to 18 currently authorised large issuers are estimated to be in the region of £35,000, and to 48 small registered issuers £10,000, within a range of +/- 25%.

The **transitional safeguarding and redemption costs** are therefore:

Large issuers 18 x £35,000 = £ 630,000

Small issuers 48 x £10,000 = £ 480,000

Total = £ 1,110,000

The projected range (+/-25%) is between £ 0.83 million and £1.4 million

1. Authorisation fees

The FSA will consult on authorisation fees in October 2010. The FSA does not usually levy fees for grandfathering existing authorised firms, but, this depends on whether the FSA holds enough information to assess whether an authorised firm meets the new standards. Because that is a decision for the FSA, which it has yet to make, this impact assessment assumes that there will be no fee for grandfathering issuers who are already authorised (based on past practice). It assumes that there may be a fee for re-registering small issuers, as there is unlikely to be sufficient information already on hand to re-register them. On the basis of the registration fees currently payable by payments institutions, this assessment assumes that small issuers who need to re-register may be charged between £500 and £1,000 each.

The **transitional authorisation costs for small issuers** are:

From: 48 firms x £500 = £24,000

To: 48 firms x £1,000 = £48,000

Midpoint: = £36,000

# Transition Benefits

The main quantitative benefits accrue to large issuers who incur lower capital requirements. Issuers may or may not reduce their capital in response to a lower regulatory requirement. This assessment scores the lower capital requirement as a reduction in the regulatory burden (just as it counts the proposed increase in the capital requirement for small issuers as an increase in the regulatory burden for small issuers).

The capital requirement for large issuer is based on 2% of total financial liabilities related to outstanding electronic money over the preceding 6 months or €1 million, whichever is higher.

Based on data provided by the FSA, there are at present 18 large issuers who hold aggregate capital of €87 million (around £73 million). The average capital per issuer at present is therefore:

£73,000,000/ 18 = £4,055,555

Around £4 million per issuer

The new capital requirement will be based on 2% of the average outstanding balance of e-money, or €350,000, whichever is the higher. The minimum capital requirement will therefore be lower than at present. The difference is illustrated in the chart below.



In the absence of comparative data about issuers’ average outstanding balances and total financial liabilities this assessment conservatively assumes that average balances are 90% of total liabilities. On this basis the assessment takes 90% of issuers’ currently held capital as representing 2% of their average outstanding balances (ie their new, lower capital requirement). This will always be higher than the minimum €350,000, based on the practical experience of current issuers.

The average current capital held by firms is £4,000,000

90% of this (the assumed average balances) is £3,600,000

Net reduction £ 400,000

The difference between the current average capital held by issuers and the new lower requirement represents the benefits to existing issuers of the new methodology. In aggregate, this is:

The **transitional benefits of lower capital requirements for large issuers** are:

£400,000 lower capital x 18 issuers = £7,200,000

Range (+/- 25%) From £5.4 million to £9 million

It is not known whether large issuers will, in fact, reduce their regulatory capital in response to the lower capital requirement. However, the capital that is released will be available for, and will no doubt be, deployed for other activities. This impact therefore scores the total reduction in the capital requirement as a benefit

# Ongoing Annual costs

There are three main sources of ongoing costs to firms:

1. New minimum capital requirements for new entrant small issuers;
2. The additional cost of capital for all small issuers.
3. New arrangements for redeeming and safeguarding customer funds
4. New minimum capital requirements for new entrant small issuers

Initial capital requirements will be calculated and applied to new entrants to the market. These are the same as those set out for existing issuers in the transitional costs section, and are assumed to apply to every new small issuer. These are additional one off costs that will be incurred by every new entrant to the market as a result of holding more capital than they would have had to hold before. The additional entry costs are estimated to be £40,000 per issuer.

It would be possible to continue to set no capital requirement for small issuers, as now. This is considered risky, given the new freedoms that small issuers will enjoy, and the experience of failures of payment service providers and of retailers that have issued prepaid cards. It is therefore proposed to set a proportionate, minimum initial capital requirement of €75,000 (£65,000) for small issuers in future. The FSA will be able to vary the capital requirement by +/-20% according to the circumstances of each issuer. Small issuers will therefore be required to hold more capital than they are estimated to hold at present. The precise number is being consulted on

The rate of entry of small firms to the e-money market is low – currently less than two a year, half of whom do not become active issuers. The rate is expected to increase as a result of the additional freedoms brought in by the directive. This assessment assumes conservatively that the rate will increase to two a year.

The ongoing annual **capital requirement for new entrant small issuers** is estimated to be:

£40,000 x 2 = £80,000

The projected range (+/- 25%) is between £40,000 and £120,000

1. Cost of capital

There is an on-going cost to small issuers from holding more capital. Given a very wide variety of firm size and business models, however, together with the absence of concrete data, any attempt to model the potential savings in ongoing lower costs of capital is fraught with difficulty. This would be done by comparing the risk free rate of return on capital with the expected rate of return in the e-money market.

In very general terms, the additional capital that small issuers may have to hold was assessed in the transitional costs section at £1,920,000 in total.

Assuming a risk free rate of return of 2.0% and an expected rate of return of 15% (net 13%) the ongoing annual cost of holding more capital is

£1.9 milllion x 13% = £247,000.

around £0.25million

Assuming the business growth rate based on the estimated number of new entrants to the market set out above, the annual cost of capital will grow to a little over £0.3 million in year 10.

1. Redeeming and safeguarding customer funds

Firms may charge fees for redeeming funds in certain circumstances. Fees must be proportionate and reflect the actual costs incurred. This measure is therefore expected to be cost neutral.

# Ongoing Annual Benefits

The main quantitative benefits accrue to large new entrants who will incur lower capital requirements than before. These are the same as those set out for existing issuers in the transitional costs section, and are assumed to apply to every large new entrant. These are additional one off benefits that will be incurred by every new entrant to the market as a result of holding less capital than they would have had to hold before. The reduction in capital for the average large new entrant is estimated to be the same as for existing large issuers. This is estimated in the transitional benefits section to be £400,000 per issuer.

Lower capital requirement

The rate of entry of to the e-money market is low – currently less than one large new entrant a year. The rate is expected to increase as a result of the additional freedoms brought in by the directive. This assessment assumes conservatively that the rate will increase to one or two a year.

The ongoing annual **capital reduction for new entrant large issuers** is estimated to be:

£400,000 x 2 = £800,000

The projected range (+/- 1 issuer) is between £400,000 and £1,200,000

The one-off reduction is estimated to apply to one or two new entrants every year, so this is an ongoing benefit of £0.4 million to £1.2 million.

Lower cost of capital

There is an on-going benefit to large issuers from a lower capital requirement, represented by a lower cost of capital. Given a very wide variety of firm size and business models, however, together with the absence of concrete data, any attempt to model the potential savings in ongoing lower costs of capital is fraught with difficulty. This would be done by comparing the risk free rate of return on capital with the expected rate of return in the e-money market.

In very general terms, the one-off benefits of lower capital requirements for 18 large issuers was assessed in the transitional benefits section at £7,200,000

Assuming a risk free rate of return of 2.0% and an expected rate of return of 15% (net 13%) the ongoing annual saving from holding less capital is

£7.2 milllion x 13% = £936,000.

around £0.9 million

Assuming the business growth rate based on the estimated number of new entrants to the market set out above, the annual saving in cost of capital will grow to a little over £1 million in year 10.

**Small firms impact**

Small firms will benefit from the ability to grant credit, provide payment services and operate payment systems. They may also carry out other, non-regulated business activities other than issuing e-money. This is set out in more detail in the consultation document.

The aggregate cost to small issuers of the new measures is estimated to be:

Transitional costs: £2.4 million (of which additional capital requirements account for £1.9m)

Ongoing costs: £0.3 million

These costs result from the proportionate application of a minimum capital requirement, and a requirement to safeguard customer’s funds. It is not considered prudent to waive them altogether. The capital costs may change. They are subject to the consultation on what is an appropriate level of regulatory capital for small issuers.

**Option 2 – Implement the Directive in full**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Breakdown of costs and benefits** | | | | | |
| **Summary of key changes** | **Potential impacts** | | **Potential benefits** | | |
|  | Transitional | On-going | Transitional | On-going | |
| New definition of e-money | £0 | £0 | Qualitative | | |
| Prudential requirements | £2.3m - £3.5m | £0.09m - £0.15m | £5.4m - £9m | | £0.4m - £1.2m |
| Cost of capital |  | £0.4m |  | | £0.9m |
| New permitted activities | £0 | £0 | Qualitative | | |
| Exemption for limited networks | £0 | £0 | Qualitative | | |
| Safeguarding e-money | £0.83m - £1.4m | £0 | Qualitative | | |
| Redemption requirements |
| Storage limits | £0 | £0 | Qualitative | | |
| Waivers for small firms | £0 | £0 | Qualitative | | |
| New authorisation requirements | £0.04m | £0 | Qualitative | | |
| **Total** | £3.1 - £4.9m | £0.49m - £0.55m | £5.4 - £9m | £1.3m - £2.1m | |

# Transition costs

Detail

There are three main sources of transition costs to firms:

* 1. New minimum capital requirements for existing small issuers;
  2. New arrangements for redeeming and safeguarding customer funds;
  3. Potentially, existing issuers may incur additional authorisation fees.

1. Minimum capital requirements for small issuers

Small e-money issuers are defined in the directive as those whose total business activities generate an average outstanding electronic money of no more than €5 million. There are an estimated 48 small active issuers out of 78 registered small issuers in the UK. This assessment excludes 30 dormant firms. The dormant firms will not be affected by the new rules. They are not trading and are expected to drop out of the register.

The capital requirements for small issuers are, at present, waived by the FSA. The FSA assess that issuers are holding a minimum level of capital in order to operate. This assessment makes a conservative assumption that small issuers are on average holding at least £25,000 of capital. This number is based on taking 4% of their reported outstanding liabilities, which average £625,000.

This option provides that small issuers would be required to hold a minimum initial capital requirement of €100,000 (£85,000). This would represent 2% of the maximum business liabilities that a small issuer may accept (€5 million).So small issuers will be required to hold more capital than they are estimated to hold at present. The difference between the current estimated average capital being held (£25,000) and the new requirement (£85,000) represents the additional capital that would be required per small issuer.

The additional capital is:

New capital requirement per issuer £85,000

Average capital being held by issuers - £25,000

Additional capital per issuer £60,000

The **transitional capital requirement for small issuers** is estimated to be:

48 x £60,000 = £2,880,000

The projected range (+/- 25%) is between £2.3 million and £3.5 million

1. Redeeming and safeguarding customer funds

The main transition costs to firms will be in issuing new terms and conditions, and making new administrative arrangements. These relate to redeeming and safeguarding customer funds, with associated compliance costs. Some firms may also need to renegotiate contracts with their programme managers.

The average direct costs to 18 currently authorised large issuers are estimated to be in the region of £35,000, and to 48 small registered issuers £10,000, within a range of +/- 25%.

The **transitional safeguarding and redemption costs** are therefore:

Large issuers 18 x £35,000 = £ 630,000

Small issuers 48 x £10,000 = £ 480,000

Total = £ 1,110,000 The projected range (+/-25%) is between £ 0.83 million and £1.4 million

1. Authorisation fees

The FSA will consult on authorisation fees in October 2010. The FSA does not usually levy fees for grandfathering existing authorised firms, but, this depends on whether the FSA holds enough information to assess whether an authorised firm meets the new standards. Because that is a decision for the FSA, which it has yet to make, this impact assessment assumes that there will be no fee for grandfathering issuers who are already authorised (based on past practice). It assumes that there may be a fee for re-registering small issuers, as there is unlikely to be sufficient information already on hand to re-register them. On the basis of the registration fees currently payable by payments institutions, this assessment assumes that small issuers who need to re-register may be charged between £500 and £1,000 each.

The **transitional authorisation costs for small issuers** are:

From: 48 firms x £500 = £24,000

To: 48 firms x £1,000 = £48,000

Midpoint: = £36,000

# Transition Benefits

The main quantitative benefits accrue to large issuers who incur lower capital requirements. Their capital requirement is based on 2% of total financial liabilities related to outstanding electronic money over the preceding 6 months or €1 million, whichever is higher.

Based on data provided by the FSA, there are at present 18 large issuers who hold aggregate capital of €87 million (around £73 million). The average capital per issuer at present is therefore:

£73,000,000/ 18 = £4,055,555

Around £4 million per issuer

The new capital requirement will be based on 2% of the average outstanding balance of e-money, or €350,000, whichever is the higher. The minimum capital requirement will therefore be lower than at present. The difference is illustrated in the chart below.



In the absence of comparative data about issuers’ average outstanding balances and total financial liabilities this assessment conservatively assumes that average balances are 90% of total liabilities. On this basis the assessment takes 90% of issuers’ currently held capital as representing 2% of their average outstanding balances (ie their new, lower capital requirement). This will always be higher than the minimum €350,000, based on the practical experience of current issuers.

The average currently capital held by firms is £4,000,000

90% of this (the assumed average balances) is £3,600,000

Net reduction £ 400,000

The difference between the current average capital held by issuers and the new lower requirement represents the benefits to existing issuers of the new methodology. In aggregate, this is

The **transitional benefits of lower capital requirements for large issuers** are:

£400,000 lower capital x 18 issuers = £7,200,000

Range (+/- 25%) From £5.4 million to £9 million

# Ongoing Annual costs

There are three main sources of ongoing costs to firms:

1. New minimum capital requirements for new entrant small issuers;
2. The additional cost of capital for all small issuers.
3. New arrangements for redeeming and safeguarding customer funds;
4. New minimum capital requirements for new entrant small issuers

Initial capital requirements will be calculated and applied to new entrants to the market. These are the same as those set out for existing issuers in the transitional costs section, and are assumed to apply to every new small issuer. These are additional one off costs that will be incurred by every new entrant to the market as a result of holding more capital than they would have had to hold before. The additional entry costs are estimated to be £60,000 per issuer.

The rate of entry of small firms to the e-money market is low – currently less than two a year, half of whom do not become active issuers. The rate is expected to increase as a result of the additional freedoms brought in by the directive. This assessment assumes conservatively that the rate will increase to two a year.

The ongoing annual **capital requirement for new entrant small issuers** is estimated to be:

£60,000 x 2 = £120,000

The projected range (+/- 25%) is between £90,000 and £150,000

1. Cost of capital

There is an on-going cost to small issuers from holding more capital. Given a very wide variety of firm size and business models, however, together with the absence of concrete data, any attempt to model the potential savings in ongoing lower costs of capital is fraught with difficulty. This would be done by comparing the risk free rate of return on capital with the expected rate of return in the e-money market.

In very general terms, the one-off costs of lower capital requirements for small issuers was assessed in the transitional costs section at £2,880,000.

Assuming a risk free rate of return of 2.0% and an expected rate of return of 15% (net 13%) the ongoing annual cost of holding more capital is

£2.9 milllion x 13% = £377,000.

around £0.4million

Assuming the business growth rate based on the estimated number of new entrants to the market set out above, the annual cost of capital will grow to a little over £0.6 million in year 10.

1. Redeeming and safeguarding customer funds

Firms may charge fees for redeeming funds in certain circumstances. Fees must be proportionate and reflect the actual costs incurred. This measure is therefore expected to be cost neutral.

# Ongoing Annual Benefits

The main quantitative benefits accrue to large new entrants who will incur lower capital requirements than before. These are the same as those set out for existing issuers in the transitional costs section, and are assumed to apply to every large new entrant. These are additional one off benefits that will be incurred by every new entrant to the market as a result of holding less capital than they would have had to hold before. The reduction in capital for the average large new entrant is estimated to be the same as for existing large issuers. This is estimated in the transitional benefits section to be £400,000 per issuer.

Lower capital requirement

The rate of entry of to the e-money market is low – currently less than one large new entrant a year. The rate is expected to increase as a result of the additional freedoms brought in by the directive. This assessment assumes conservatively that the rate will increase to one or two a year.

The ongoing annual **capital reduction for new entrant large issuers** is estimated to be:

£400,000 x 2 = £800,000

The projected range (+/- 1 issuer) is between £400,000 and £1,200,000

The one-off reduction is estimated to apply to one or two new entrants every year, so this is an ongoing benefit of £0.4 million to £1.2 million.

Lower cost of capital

There is an on-going benefit to large issuers from carrying a lower capital requirement represented by a lower cost of capital. Given a very wide variety of firm size and business models, however, together with the absence of concrete data, any attempt to model the potential savings in ongoing lower costs of capital is fraught with difficulty. This would be done by comparing the risk free rate of return on capital with the expected rate of return in the e-money market.

In very general terms, the one-off benefits of lower capital requirements for 18 large issuers was assessed in the transitional benefits section at £7,200,000

Assuming a risk free rate of return of 2.0% and an expected rate of return of 15% (net 13%) the ongoing annual saving from holding less capital is

£7.2 milllion x 13% = £936,000.

around £0.9 million

Assuming the business growth rate based on the estimated number of new entrants to the market set out above, the annual saving in cost of capital will grow to a little over £1 million in year 10.

**Small firms impact**

Small firms will benefit from the ability to grant credit, provide payment services and operate payment systems. They may also carry out other, non-regulated business activities other than issuing e-money. This is explained in more detail in the consultation document.

The aggregate cost to small issuers of these measures is:

Transitional costs: £3.8 million (of which additional capital requirements account for £2.8m)

Ongoing costs: £0.9 million

# Annexes

Annex 1 should be used to set out the Post Implementation Review Plan as detailed below. Further annexes may be added where the Specific Impact Tests yield information relevant to an overall understanding of policy options.

# Annex 1: Post Implementation Review (PIR) Plan

A PIR should be undertaken, usually three to five years after implementation of the policy, but exceptionally a longer period may be more appropriate. A PIR should examine the extent to which the implemented regulations have achieved their objectives, assess their costs and benefits and identify whether they are having any unintended consequences. Please set out the PIR Plan as detailed below. If there is no plan to do a PIR please provide reasons below.

|  |
| --- |
| **Basis of the review:** [The basis of the review could be statutory (forming part of the legislation), it could be to review existing policy or there could be a political commitment to review];  The Directive requires the European Commission to carry out a post implementation review by 1 November 2012. |
| **Review objective:** [Is it intended as a proportionate check that regulation is operating as expected to tackle the problem of concern?; or as a wider exploration of the policy approach taken?; or as a link from policy objective to outcome?]  The review will look at the implementation and impact of the directive, in particular on the application of prudential requirements for e-money institutions |
| **Review approach and rationale:** [e.g. describe here the review approach (in-depth evaluation, scope review of monitoring data, scan of stakeholder views, etc.) and the rationale that made choosing such an approach] |
| **Baseline:** [The current (baseline) position against which the change introduced by the legislation can be measured] |
| **Success criteria:** [Criteria showing achievement of the policy objectives as set out in the final impact assessment; criteria for modifying or replacing the policy if it does not achieve its objectives] |
| **Monitoring information arrangements:** [Provide further details of the planned/existing arrangements in place that will allow a systematic collection systematic collection of monitoring information for future policy review] |
| **Reasons for not planning a PIR:** [If there is no plan to do a PIR please provide reasons here]  The review will be carried out at the European level. |

Add annexes here.

1. Race, disability and gender Impact assessments are statutory requirements for relevant policies. Equality statutory requirements will be expanded 2011, once the Equality Bill comes into force. Statutory equality duties part of the Equality Bill apply to GB only. The Toolkit provides advice on statutory equality duties for public authorities with a remit in Northern Ireland. [↑](#footnote-ref-1)
2. Race, disability and gender Impact assessments are statutory requirements for relevant policies. Equality statutory requirements will be expanded 2011, once the Equality Bill comes into force. Statutory equality duties part of the Equality Bill apply to GB only. The Toolkit provides advice on statutory equality duties for public authorities with a remit in Northern Ireland. [↑](#footnote-ref-2)