



BERMUDA MONETARY AUTHORITY

DISCUSSION PAPER

MONEY SERVICE BUSINESS, PAYMENT SERVICES, and FOREIGN EXCHANGE SERVICES.

April 2014

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The financial services industry and other interested parties are invited to submit their views on the proposals set out in this paper. Comments should be sent to the Authority and addressed to policy@bma.bm no later than **30th June** 2014.

I. Introduction

1. Money Service Business ('MSB') has grown globally as consumers seek efficient and convenient access to banking-related services which they may not have access to through normal banking channels. Another driver of growth has been the increasing movement of migrant workers who require banking-related services to transfer funds back to their home countries without having to establish formal relationships with the normal banking industry¹. In addition, such workers may facilitate transfers to relatives in developing countries where large portions of the population do not have access to banking facilities.

2. Generally speaking, the role of MSBs varies globally, but usually involves the provision of a variety of services to the public. In the US, MSBs are termed as non-bank financial institutions and the Department of Treasury's definition includes: money transmitters; payment instrument sellers; stored-value providers; cheque cashers; issuers or sellers of traveler's cheques or money orders; and currency dealers or exchangers. MSBs in the US are not permitted to accept deposits or make loans.

3. In the UK, Her Majesty's Revenue and Customs defines a MSB as any business that exchanges currency transmits money or cashes cheques for their customers.

4. In Bermuda, Section 20AA of the Bermuda Monetary Authority Act 1969 ('the BMA Act') defines MSB as the business of providing certain specific services to the public including: issuing credit or debit cards; providing electronic payments; payments done over the internet; foreign currency exchange; and money transmission services. The definition in Bermuda is wider than the UK MSB legislation as it includes payment, whereas in the UK, payments are covered under separate legislation.

5. The growth of MSBs globally has allowed for an expansion of new lines of businesses, e.g., payment services businesses, in line with the changing electronic marketplace. Over the

¹ See 'Mobile Money transforming the lives of the unbanked and banked,' <http://www.ghanaweb.com/GhanaHomePage/NewsArchive/artikel.php?ID=277333>

past 18 months, entrepreneurs have discussed various payment services initiatives with the Authority. The Bermuda Monetary Authority ('the Authority') believes that it is an opportune time to review the effective regulatory oversight of existing licensees, to clarify the scope of their current activities in line with the existing Regulations, and to provide opportunities for new entrants.

6. This Discussion Paper is intended to assist the Authority to determine the best approach to ensure that this financial sector is both appropriately regulated in line with global best practice, while still facilitating its growth and development. The Paper will review an approach to regulate MSBs and in particular, payment services. The Paper will also consider issues which arise in this sector that could affect its viability. This includes the ability to carry out foreign exchange and how that may be managed under Bermuda law.

II. Background

7. It has been said that the global business environment is undergoing a remarkable period² of change. This change is driven primarily by the rapid uptake of e-commerce activity. The use of electronic payments and the sophisticated computer networks that unite consumers, merchants and financial institutions requires systems that are faster, more convenient and safer. As a result, payment options for e-business are rapidly evolving due to changing customer demographics and the application of new technologies, among other factors³.

8. The global payment system is also becoming more complex⁴ as banks and other traditional processors adopt new technologies and new payment alternatives. With this ongoing innovation, it is becoming increasingly necessary for regulators to adopt appropriate regulation of the financial markets to ensure safe, efficient, and accessible payments that support economic activity and help maintain global competitiveness.

² 'Payment System Improvement'-Public Consultation Paper, The Federal Reserve Banks, September 10, 2013.

³ World Bank eLibrary, 'Transforming Payment Systems'

⁴ Revised Payment Services Directive 2013/0264(COD)

9. The need for better regulation of payment services has been formally recognised in many jurisdictions including both the EU⁵ and US. In July 2013, the EU issued a revised Payment Services Directive known as PSD2 which modifies its 2009 Payment Services Directive (PSD). In September 2013 the Federal Reserve Bank issued a paper entitled “*Payment System Improvements-Public Consultation Paper*” which sought input from industry and the public on what changes were needed to improve the US system⁶.

10. The Authority has experienced an increase in enquires seeking information on the possibility of operating both payment services and foreign exchange services on both an integrated and stand-alone basis.

11. It is against this backdrop, and the opportunity to assist in the development of this emerging market in Bermuda, that the Authority was prompted to review the existing Money Service Business Regulations 2007 (‘the Regulations’), new developments for payment legislation, and the existing Exchange Control Act 1972 with a view to identifying opportunities for improvement that are in line with emerging best practice and that take into consideration the use of rapidly changing technologies.

III. Money Service Business (MSB)

12. As noted earlier, Section 20AA of the BMA Act defines Money Service Business as the business of providing certain services to the public. including electronic payments, payments done over the internet, and foreign currency exchange.

13. A growing component of the global MSB system is payment services business. Typically, a payment services business,⁷ offers online services for accepting electronic payments by a variety of payment methods including credit cards, bank-based payments such as direct debit, bank transfer, and real-time bank transfer based on online banking. Often, these companies use software in their service model and form a single technical gateway for

⁵ (PSD2) as revised

⁶ ‘Payment System Improvement’-Public Consultation Paper, the Federal Reserve Banks, September 10, 2013.

⁷ Also known in the US as a **Payment Service Provider** (“PSP”), or in the EU as a **Payment Institution**.

their client to multiple payment methods⁸. They may also make online bill payments on behalf of their customers including cross-border payments.

14. While some payment services offer limited services, a full-service Payment Service Provider (“PSP”) may offer risk management services for card and bank-based payments⁹, transaction payment matching, reporting, fund remittance and fraud protection in addition to multi-currency functionality and services. Some PSPs provide services to process newer methods of payment including: cellular or mobile phone technology-based payment systems; electronic money systems; prepaid cards or vouchers; and even paper or e-cheque processing.

15. Internationally, a PSP may utilise the services of multiple acquiring banks, for their credit card and foreign exchange networks and in many cases, the PSP will fully manage these relationships with the external network and bank accounts¹⁰. This makes the customer less dependent on traditional banking institutions for services such as wire transfers and foreign exchange transactions when making international transactions. Additionally, by negotiating bulk deals, PSPs purport to offer lower fees and better foreign exchange rates than some banking institutions¹¹.

16. While it appears as if the policy underlying the adoption of the regime for regulation of MSBs under the BMA Act anticipated the growing and changing use of technology in the payments industry, the supporting the Regulations was not updated to reflect these developments. For example, the Regulations as currently drafted do not adequately address the type of regulatory oversight required for the issuing of credit and debit cards, and prohibit the holding of client deposits which are necessary for the operation of card facilities. To date, card services have been primarily provided by the local banks which are regulated under the Banks and Deposit Companies Act 1999. To be able to undertake this type of business, entities other than banks must partner with a local bank that will provide the customer deposit facilities required to hold client funds.

⁸ Online dictionary definition

⁹ A guide to payment Services- UK Payments Council

¹⁰ Information from former HSBC Senior Merchant Services Officer

¹¹ UK Payments Council.

17. As evidenced from both the US and UK definitions of MSB, the issuing of credit and debit cards is not an activity that jurisdictions automatically allow MSBs to engage in. The Authority is of the view that this is a policy which needs to be revisited with a view to amending/limiting the list of permitted activities for money service businesses.

18. Furthermore, Regulation 6(3) of the Regulations explicitly prohibits a MSB from holding client monies or any other assets which frustrates the effective operation of a payment service.

19. In view of these operational challenges, the Authority is seeking input from the market to assist with the update to the current legislative framework to allow Bermuda to meet international standards for the sector and to provide opportunities for prospective new entrants.

20. The Authority is considering that the way forward could include several options such as;

(a) Developing additional MSB regulations that cover all of the activities allowed by the existing MSB definition;

(b) Narrowing the scope of the activities which may be undertaken by MSBs.

(c) Removing the existing definition of MSB from the BMA Act and developing a new stand-alone act for MSB along with enhanced and expanded regulations.

IV. Payment Services

21. The Authority recognises that a safe, reliable and efficient payment system is central to the stability of the Bermuda financial system. Therefore, the Authority seeks input about enhancing oversight and regulation of payment services which could help to develop effective, efficient, reliable, accessible and secure payment systems that serve the needs of Bermuda's customers and support a competitive private sector environment.

22. As part of its research into **payment systems** and **payment services**, the Authority reviewed work done in several jurisdictions including the EU, UK, US, Ireland, Jamaica,

Trinidad and Tobago, as well as the World Bank, and the Bank for International Settlements. Areas of particular interest to the Authority include: legal and regulatory frameworks, foreign exchange settlement systems and cross-border payments and remittances.

23. After reviewing the legislation from several jurisdictions, the Authority has found the PSD2 to be very comprehensive and provides a good detailed framework for the regulation of payment services businesses. The Authority is also of the view that the UK's Payment Services Regulations 2009 – as transposed from the original 2009 EU Directive – could serve as a starting point for developing payment services regulations that are fit for purpose for the Bermuda market.

24. It is important to note that payment services may utilise foreign exchange services as a key component of the business structure, particularly when dealing with global cross-border payment services. Article 17 of the PSD2 grants payment services businesses the right to engage in foreign exchange activity and specifically states that in addition to the provision of payment services, payment institutions shall be entitled to engage in the following activities:

“(a) the provision of operational and closely related ancillary services such as ensuring the execution of payment transactions, foreign exchange services, safekeeping activities, and the storage and processing of data”.

25. The recently completed work on payment service regulation in the PSD2¹² includes provisions which take into account new types of payment services such as payment initiation services offered in the context of e-commerce. The PSD2 recognises that technology brought innovation and competition to the payments market by providing alternative, and often cheaper, payment solutions for internet payments. As these new types of payment services were not regulated, they have been brought within the scope of the PSD2 to boost transparency, innovation and security.

26. Additionally, the PSD2 is said to have enhanced transparency for consumers through its information requirements for PSPs (execution time, fees) and it has reinforced the rights

¹² Directive of the European Parliament and of the Council on payment services in the internal market, COM(2013) 547/3

and obligations linked to payment services such as shorter execution time, refund rights, liability of consumers and payment institutions.¹³

27. Given that the existing MSB regulations on payments are very limiting and do not accommodate for the growth in the area of payment services businesses, the Authority is considering that the way forward could be one of the following:

(a) Develop a new standalone payment services Bill with accompanying regulations.

(b) Develop payment services regulations which could be added as a new section to the existing MSB Regulations.

(c) Develop payment services regulations that would be incorporated as part of a new legislation for MSBs.

V. Foreign Exchange Services

28. As part of this review of payment service business and the regulation of MSB's under Bermuda, it is necessary to focus on how to address foreign exchange services. Foreign exchange transactions encompass everything from "the conversion of currencies by a traveler at an airport kiosk to billion-dollar payments made by corporate giants and governments for goods and services purchased overseas. Increasing globalisation has led to a massive increase in the number of foreign exchange transactions in recent decades. The global foreign exchange market is by far the largest financial market, with average daily volumes in the trillions of dollars"¹⁴.

29. In Bermuda, foreign currency exchange services have been primarily provided to the public by banks and deposit companies. The use of foreign currency in making cross-border payments is addressed in the Exchange Control Regulations 1973¹⁵ and Part III, sections 8 - 11 of those regulations give the conditions under which payments can be made on behalf of

¹³ European Commission - MEMO/13/719 24/07/2013, Payment Services Directive and Interchange fees Regulation: frequently asked questions, Brussels, 24 July 2013.

¹⁴ See Investopedia article on....

¹⁵ Available at www.Bermudalaws.bm

Bermuda residents both into and out of Bermuda. These sections also include certain restrictions on the rate of exchange for these transactions subject to the discretion of the official Controller of Exchange Control.

30. Part V, section 26 of the Exchange Control Regulations 1973 highlights restrictions on the import and export of foreign currency and specifically restricts these activities to “authorised dealers”. Authorised dealers are defined in the regulations as a person authorised by the Minister of Finance to be an authorised dealer, by Notice published in the Official Gazette. To date, only banks and deposit companies have been designated as authorised dealers.

31. Given that MSBs are allowed to engage in foreign currency exchange business and are subject to the foreign currency purchase tax, the Authority is of the view that, by virtue of their licence, they will be performing a function of an authorised dealer. It follows that while acting on behalf of customers, a MSB or a payment services business that performs foreign currency exchange transactions would also need to be considered as authorised dealers subject to the Exchange Control Act 1972 (and the Regulations made thereunder.)

32. Due to the growing public interest in foreign exchange opportunities in Bermuda and the opportunity to play a bigger role in the global foreign exchange market, the current Exchange Control Regulations 1973, are in need of review. The Authority has commenced a review of the remaining elements of the exchange control regime and has had preliminary discussions with the legal subcommittee of the Bermuda Bankers’ Association to get a better appreciation of some of the challenges that they face.

33. Given that payment services and foreign exchange are intricately intertwined, it will be necessary to examine Bermuda’s regulatory framework and the potential impact that changes to one area might have other areas, including pre-existing laws.

34. The Authority is therefore suggesting that legislation pertaining to foreign exchange services should be reviewed from two aspects:

(a) Foreign currency exchange service by an independent provider as a primary role;
and

(b) Foreign currency exchange as an ancillary role in the payment services business.

VI. Conclusion

35. The ideas and recommendations in this paper are intended to open the debate about updating the legislation identified. The Authority believes that updating specific legislation will help to create an environment that fosters innovation in the Bermuda market.

36. Accordingly, the Authority seeks input from our industry partners and the public at large on the issues which have been raised regarding the present regulation of MSBs, the proposed enhanced regulation of payment services and the approach to be taken to deal with foreign currency exchanges. The Authority welcomes views on these proposals as well as any other related issues which the reader may deem appropriate.

Appendix

In an effort to stimulate discussion on the topic of payment services and foreign exchange services, the Authority is inviting our stakeholders to consider the following issues as they prepare their responses:

1. Is there a need for more foreign exchange payment services options that would help consumers pay bills that they might have overseas? (examples might be college tuition, or a college student's rent etc.)?
2. Is there a need for more competitive and accessible foreign exchange services for both business and personal needs?
3. Is the existing Exchange Control Act 1972 (and the Regulations made thereunder) still appropriate?
4. Are there any other issues related to MSB, payment services, foreign currency exchange, or the use of technology in these services that you would like to see addressed?
5. What are the challenges presented to existing providers of foreign exchange services who operate in accordance with the delegations provided by the Controller of Foreign Exchange?
6. What are the types of payment services and foreign exchange services that service providers wish to provide to Bermuda consumers?
7. What are the types of international payment services or foreign exchange services that service providers would like to extend to overseas consumers?
8. To what extent would new foreign exchange operations or payment services operations need to be supported by/partnered with a local bank for the provision of services to allow their business model to work?
9. What are the potential risks that customers should be aware of when dealing with payment services/forex businesses (e.g. cybercrime/rate manipulation/inappropriate system/poor AML/ATF oversight) and what are the expectations of overseas regulators or prohibitions covering cross border activities?

The Authority would like to thank its stakeholders for assisting with this public consultation.