Regulating store-within-a-store and online marketplaces

Hester Bais and Nadja van der Veer, two payments lawyers with a wealth of experience of the international payments industry, in this two-part article discuss store-within-a-store platforms, a business model where large online shops offer smaller online shops' goods and services, in addition to their own products. Hester and Nadja, in this first installment, provide the background to their argument that E-Commerce Platforms (the term 'E-Commerce Platform' is used to describe both store-within-a-store and online marketplaces) that handle payment transactions should be legally regulated as financial institutions, specifically focusing on the approach taken by the Dutch Central Bank.

Even though consumers shop on an E-Commerce Platform's website, the buyer enters into a 'purchase' agreement with the affiliated online shop or seller and it is that party which handles delivery, fulfilment and provides remedies in case of disputes[1]. The E-Commerce Platform handles the payment processing and executes the transaction between the consumer and the affiliated online shop/seller via the payment methods offered on the E-Commerce Platform's website. Examples of well-known store-within-a-store platforms include Bol.com and Google Play, and examples of major online marketplaces include Alibaba, Amazon and even Uber and AirBnB. Despite the fact that these E-Commerce Platforms handle payment transactions however, they often remain outside of the scope of financial services regulations. This article questions whether this doctrine is indeed appropriate from a risk management perspective. We will discuss how regulators perceive, define and classify these E-Commerce Platforms. In our view, the Dutch Central Bank ('DCB') should consider these E-Commerce Platforms as financial service providers and as such companies that should abide by similar rules and regulations as payment services providers ('PSPs') and payment facilitators ('PFs').

Benefits of store-within-a-store platforms

Store-within-a-store platforms offer smaller retailers many benefits, such as cheap transaction rates and integrated risk management. Large e-commerce retailers have invested in brand awareness and their platforms offer consumers a choice between different payment methods in a variety of currencies. Their high transaction volumes result in low buy-in rates.

Regulatory framework

How should we classify and regulate the execution of payment transactions by large E-Commerce Platforms on behalf of smaller online shops? E-Commerce Platforms receive payment in their bank account, which is then forwarded to the associated online shop. The risk faced by the online shops is that their funds are not segregated from the E-Commerce Platform's funds.

We will discuss the regulatory framework on the basis of two legal concepts we deem applicable to E-Commerce Platforms: the prohibition to withhold repayable funds and the prohibition to perform payment services without a regulatory licence.

Repayable funds

In the Netherlands, it is prohibited to attract, receive and/or hold repayable funds from the public, while undertaking business activities[2]. This prohibition and a definition of 'repayable funds' is incorporated into the current financial services legislation in the Netherlands (the Dutch Financial Supervision Act - hereinafter the 'FSA') and dates back to a policy rule issued in 1992 by the DCB. The term is an important concept in determining whether activities fall within the scope of the FSA[3]. E-Commerce Platforms fall into the category of an intermediary, as used by the DCB.

The definition of repayable funds: Repayable funds are funds that must be repaid at some point in time. The word 'repaid' is interpreted very strictly by the DCB and refers to funds that have to be returned to the originator (purchaser). However, this means that the definition of repayable funds cannot be applied when the third party holds funds for a beneficiary and not for the originator. In our view, this choice of words has great implications and could have unforeseen consequences. Even though other rules apply since the introduction of the Payment Services Directive ('PSD'), this definition should be applied to intermediaries, such as E-Commerce Platforms, PSPs and/or PFs. An intermediary executes online payment transactions as an online shop and receives funds on behalf of the small retailer (as a beneficiary). These funds, held by the intermediary, could and should be considered as 'repayable funds.' The fact that it does not constitute actual repayment but continued payment, does not imply that it cannot be reclaimed by another party. In this case, the other party is not the originating source of the

payment (purchaser) but the final beneficiary of the payment (seller). Unfortunately, the DCB definition refers to the literal meaning of repayable funds, rather than welcoming a more contextual interpretation. As a consequence, the prohibition to attract, receive and/or hold repayable funds does not apply to E-Commerce Platforms, even though PSPs and PFs are subject to FSA licence requirements. In our view, the DCB's position is incomprehensible and flawed. This simple exemption has great consequences and results in an uneven e-commerce landscape, in which both regulated parties and unregulated parties operate.

Regulator inconsistencies? The DCB's strict interpretation also proves to be inconsistent with the views of the legislator and The Netherlands Authority for the Financial Markets ('AFM'). For instance, the AFM seems to have taken the position that crowdfunding platforms attract, receive and/or hold repayable funds[4]. The Minister of Finance has indicated that amendments are being made to the FSA Exemption Regulations, in order to exempt crowdfunding platforms from the prohibition to attract, receive and/or hold repayable funds, which is expected to be effective as of 1 January 2016[5]. It is unclear how holding funds by a crowdfunding platform differs from holding funds by an E-Commerce Platform. This raises the question as to why these two platforms should be considered differently from a legal perspective. It would be logical to consistently apply one regime for the collection and safeguarding of funds by foundations on behalf of third parties, irrespective of whether these foundations are associated with a payment institution, investment firm, E-Commerce Platform or other.

Examples of major online marketplaces include Alibaba, Amazon and even Uber and AirBnB. Despite the fact that these E-Commerce Platforms handle payment transactions however, they often remain outside of the scope of financial services regulation

Intermediaries, continued payment and repayable funds: Apart from the question of whether funds are repayable or not, the DCB has determined that another criteria is relevant to the applicability of its prohibition. The receipt of funds by an intermediary which is subsequently transferred to the associated online shop has often been referred to by the DCB as a 'continued payment.' The question arises whether the prohibition to attract, receive and/or hold repayable funds applies to cases where continued payment occurs. In 2002, the DCB issued a policy[6], which provides that under certain conditions, the continued payment of funds by intermediaries is not considered as 'attracting, receiving and/or holding of repayable funds.' This implies that the prohibition does not apply here. One wonders why such crucial criteria results in a different outcome.

The DCB claims that continued payments concern transactions provided to a third party in relation to a concrete order for continued payment to the ultimate beneficiary. During the period that the third party holds the funds, these funds are not considered repayable. Reference to the repayment criteria is provided again by the DCB: these are not repayable as they do not need to be repaid at a certain moment in time. There is a condition, however, as these funds may only be held by the intermediary as long as necessary from a technical and organisational perspective[7]. The DCB linked this condition to a maximum settlement term to the beneficiary of five calendar days. If held longer, the funds become repayable.

The DCB provides an intermediary statement that gives continued payments even more leeway: funds can be held for a maximum period of one month if necessary from a technical and organisational point of view. In order to justify this flexibility, the DCB presents two examples where this may be necessary: to enable batch-payments or for the benefit of administration. This one month term is outdated, if one considers the current timeframes in which payment transfers from one bank account to another are made. It is also out of sync with FSA rules which apply to payment transactions; making funds available within one day to the client by payment institutions.

Furthermore, the current status of payment and banking technology no longer justifies withholding funds for such a long period. Other rules apply to intermediaries and the question is if the regulator truly understands the impact of its ruling. This view remained unchanged under the 2005 policy[8] and has been copied in its entirety in the parliamentary commentary of the now-current FSA articles, applicable to payment and other financial institutions. The DCB upholds this view, despite the revolutionary technological changes in the financial services, e-payments and e-commerce industry in the past three decades.

The result of this approach by the DCB is an unbalanced market which is not justifiable, considering the risks for both payees and payers. At a European level, it has been determined that all payment services must be regulated, unless explicitly exempt under the Directive.

It is undesirable for the Netherlands to take a different stand, as it violates European rules and creates an uneven and unsafe playing field. The suspicion arises

as to whether this flawed interpretation may have deliberately been chosen for political reasons, so that the DCB does not have to supervise these intermediaries.

Payment services by E-Commerce Platforms

The DCB's view is that the prohibition to attract, receive and/or hold repayable funds does not apply to E-Commerce Platforms, either because the funds are not repayable or because they provide continued payment. However, there is another option which includes parties in the regulated world of financial services, namely those that provide payment services and must be licensed as a payment institution. Unfortunately, the DCB seems to have taken a stand to ensure that E-Commerce Platforms do not fall within the scope of regulated payment activities. Three arguments are defined and often used by the DCB as to why these companies fall outside the scope of regulated payment activities: they are providing payment services as an ancillary activity; they discharge the payment obligation of the buyer once received by the intermediary; and the commercial agent exemption.

The Dutch legislator did acknowledge the difficulties around determining whether a party is a payment institution or not. In the explanatory memorandum[9] of the FSA, the legislator clarified that it includes parties who execute payment transactions and momentarily keep funds, for example, internet payment companies who offer different payment methods to customers and collect the funds on behalf of an online shop through a payment account held for the online shop. Further, the DCB has clarified on its website[10] which payment services fall outside of the scope of the FSA. Those excluded include payment services, where only cash is involved and no payment accounts are held by the intermediary on behalf of the beneficiary[11]. The same applies to technical service providers, in support of another company in the provision of payment services[12] (again, as long as the service provider never comes into possession of funds). Looking at the clarifications provided and which services fall under the financial services licensing requirements[13], it mostly concerns activities where the intermediary holds a payment account on behalf of its customer. Whether or not an intermediary attracts, receives and/or holds funds seems to be the crucial and determining factor. If this is the case, parties which fall within the scope of the FSA should include E-Commerce Platforms.

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Part two of this article - to be published next month - will continue the discussion concerning E-Commerce Platforms and whether they should be regulated as financial services providers. The article will include analysis of the revised Payments Services Directive in this context, and the similarities between E-Commerce Platforms, merchant aggregation and PSPs.

1. This is not an entirely new phenomenon. In the travel and car rental industries, various online intermediaries exist that for instance offer hotel rooms or cars on behalf of other companies. Different from the case described in this article however, these intermediaries are not involved in payment for the purchase as this is done directly with the actual service provider. The online intermediary only receives a commission per transaction.
2. Articles 1:1 and 3:5 of the Dutch Financial Supervision Act.
3. http://www.toezicht.dnb.nl/en/2/51-201848.jsp
4. Letter Minister of Finance, 31 March 2015, reference FM/2015/371 M, https://www.rijksoverheid.nl/ministeries/ministerie-van-financien/documenten/kamerstukken/2015/03/31/kamerbrief-over-voortgang-aanpassingen-regelgeving-crowdfunding
5. However, strangely enough, this interpretation by AFM seems inconsistent with earlier interpretations. In an interpretation guidance issued by DCB and AFM, they claimed that the Article 3:5 prohibition of the Financial Supervision Act does not apply to crowdfunding platforms, while referencing the DCB interpretation of 'continued payment' ('DNB en AFM geven interpretatie over crowdfunding').
6. The policy of the DCB on key concepts of market access and enforcement of the Act on the Supervision of the Credit System 1992, published on 10 July 2002 (Law Gazette of 10 July 2002. Nr 129).
7. www.toezicht.dnb.nl/3/50-224922.jsp
8. The policy of the DCB on key concepts of market access and enforcement of the Act on the Supervision of the Credit System 1992, published on 31 December 2004 (Law Gazette of 31 December 2004. Nr 254).
9. From the House of Representatives of the Netherlands, ('Kamerstukken II,' year 2008–2009, 31 892, nr. 6, page 15).
10. http://www.toezicht.dnb.nl/2/50-226038.jsp
11. Article 1:5a, paragraph 2, sub a, c through g of the Dutch Financial Supervision Act.
12. Article 1:5a, paragraph 2, sub j of the Dutch Financial Supervision Act.
13. http://www.toezicht.dnb.nl/2/50-226036.jsp