Regulating store-within-a-store marketplaces: part 2

In this second installment of a two-part article, Hester Bais and Nadja van der Veer, two payments lawyers with a wealth of experience on the international payments industry, continue their discussion of E-Commerce Platforms (the term 'E-Commerce Platform' is used to describe both store-within-a-store and online marketplaces) and whether they should be regulated as financial services providers.

Ancillary services

In 2013, the Dutch Central Bank ('DCB') responded to the question as to whether the prohibition on providing payment services without a licence also applied to those companies that offer a commercial/selling platform[1]. This party was defined as any internet company that acts as intermediary in the conclusion of online purchase agreements between participating webshops and customers. Webshops provide a data file with their product assortment, after which the intermediary places these products on its website. Customers can review the prices of the different webshops and order the product. After a purchase, the intermediary subsequently transfers the payment minus its commission to the Webshop. In our view, store-within-a-store platforms are comparable to the platforms described by the DCB. Surprisingly, without any reference to repayable funds or continued payment, the DCB clarifies that the scope of the Payment Service Directive ('PSD') is limited to payment institutions whose main activity consists of the offering of payment services as an independent identifiable activity[2]. This, according to the DCB, does not include companies that merely provide payment services in support of other main activities (not being payment services). With this passage, the DCB seems to take the standpoint that commercial/selling platforms (and therefore store-within-a-store platforms) do not provide payment services as their core business and are therefore exempt from the licensing requirements under the PSD. Another example of an incomprehensible point of view that contradicts the perspective of the European legislator.

Discharge of payment obligation

It gets even worse! In many cases, the payment made by the purchaser to the E-Commerce Platform will immediately discharge the purchaser from its payment obligation, even before the payment has reached the associated webshop. Even if the payment made by the purchaser never reaches the webshop, for instance, if the intermediary does not fulfill its contractual obligation to subsequently settle/continue to pay collected funds, the purchaser has fulfilled its payment obligation and has the right to receive the purchased good/service. This has led the DCB to conclude that this is a clear case of continued payment and not of a payment service. This conclusion is remarkable; many Payment Service Providers ('PSP') come to a contractual agreement with their merchants that a consumer is discharged from its payment obligation, once the payment is received by the PSP. According to the interpretation of the DCB such PSPs would then not need a licence (anymore). The webshop will not be protected by the PSD, yet this directive aims to protect both payers and payees. Moreover, imagine if the consumer is made liable if a PSP goes bankrupt. The consumer should not suffer the consequences of a webshop choosing to partner with an intermediary E-Commerce Platform. In our view, whether or not the purchaser is discharged from its payment obligation can never be a determining factor when classifying whether a party is a payment institution or not.

Misuse of the commercial agent concept

Unfortunately, there is yet another route available to exclude these E-Commerce Platforms from Dutch Financial Supervision Act ('FSA') rules and regulations, which is the regulatory exemption of commercial agent. European E-Commerce Platforms are often classified as commercial agents, not only by the DCB but also other European supervisory bodies[3]. Payment transactions that are executed through a commercial agent, which acts on behalf of the payer or the payee, are exempt from financial services regulations. They are an intermediary that acts for the account of its customer, with whom it has an enduring commercial relationship (not just on the basis of an incidental transaction). This creates a legal vacuum that leads to abuse. Fortunately, this has come to the attention of the European Commission ('EC') and the Revised Payment Services Directive ('PSD2') should end the 'misuse' of this exemption.

As explained in the previous chapters, regulations, prohibitions and/or licensing requirements may apply in two ways. However both options are rejected by the DCB for intermediaries and therefore for these E-Commerce Platforms. From a risk management perspective, this results in an undesirable situation where neither the payee nor the payer is being

protected by the regulator. This type of unlevelled playing field carries risks that are unjustifiable.

PSD2 and Europe

Our position, that discharge of the payment obligation is irrelevant, is supported at a European level. An impact study of the PSD in the EU[4] was conducted at the request of the EC. It said: "[…] exempting payment collection services must be seen as a purely purposive interpretation of the PSD. However, the rationale that apparently gave rise to the purposive interpretation (the payee takes up the risk of the provider's default) is not entirely in line with the PSD. The PSD aims at protecting payment service users in general and not payers only." One should conclude that any agreed discharge of a payer - once the intermediary has received the payment - can never be a decisive factor in determining whether payment services are being provided. The PSD protects all payment service users.

Furthermore, support is given to our view that the commercial agent exemption is misused. Consideration number 11 of the PSD2 text stipulates: "The exclusion from the scope of Directive 2007/64/EC of payment transactions through a commercial agent on behalf of the payer or the payee is applied very differently across the Member States. Certain Member States allow the use of the exclusion by e-commerce platforms that act as an intermediary on behalf of both individual buyers and sellers without a real margin to negotiate or conclude the sale or purchase of goods or services. Such application of the exclusion goes beyond the intended scope set out in that Directive and has the potential to increase risks for consumers, as those providers remain outside the protection of the legal framework. Differing application practices also distort competition in the payment market." To address those concerns, the exclusion should therefore apply when agents act only on behalf of the payer or only on behalf of the payee, regardless of whether or not they are in possession of client funds. Where agents act on behalf of both the payer and the payee (such as certain e-commerce platforms), they should be excluded only if they do not, at any time, enter into possession or control of client funds.

European E-Commerce Platforms are often classified as commercial agents. Payment transactions that are executed through a commercial agent, which acts on behalf of the payer or the payee, are exempt from financial services regulations

For this reason, it is prudent that the exemption for commercial agents is defined more precisely, as determined by the EC. These parties should safeguard the funds of their users, even if done via the first route (rather than the second of determining that payment services are provided), namely an exemption to the prohibition regarding repayable funds. Declaring them out of scope is not an option.

On the basis of the above statement made by the EC in the legislative text one could conclude that E-Commerce Platforms are indeed providing payment services, because they temporarily possess and control their clients' funds. Unfortunately the statement is only reflected in the Directive's considerations part and not further embedded in the text as a regulatory provision/obligation. In April 2014, in its commentary on the draft PSD2[5], the European Payment Institution Federation ('EPIF'), insisted on clarification by the EC with regards to the application of the PSD to merchant aggregators/ marketplaces and similar models. EPIF mentioned that it is not sufficiently clear how the PSD applies, particularly in respect of AML obligations and handling settlement funds. Unfortunately, this call for clarity has not been entirely answered and the EC missed a great opportunity - with the forthcoming PSD2 - to clarify the position of E-Commerce Platforms in relation to the PSD. The consideration will not suffice.

Merchant aggregation in its newest form

Under card brand (Visa and MasterCard) rules, you could argue that an E-Commerce Platform, processing third party transactions, is quite similar to merchant aggregation. Merchant aggregation occurs when a company uses its own merchant account to accept credit cards as payment for goods/services provided by others. Aggregation is prohibited by the card schemes. However, PSPs and payment facilitators ('PFs') are authorised models under the card schemes and are allowed to aggregate merchant transactions and accept credit cards for payment transactions of others. A PSP or PF receives settlement on behalf of a sponsored/sub-merchant. If based in the EEA, it is required to have a payment institution licence. Why don't the same rules apply to E-Commerce Platforms? Quite remarkably, MasterCard recently announced at the MasterCard Global Risk Conference in Berlin (October 2015) that marketplaces are not to be classified as PFs. We will have to wait and see if the card schemes introduce marketplaces as a new classification of service providers, next to PSPs and PFs.

The similarities between E-Commerce Platforms and PSPs/PFs

These E-Commerce Platforms offer associated webshops/sellers the possibility to offer their buyers payment methods and facilities already integrated on the e-

Commerce Platform; PSPs and PFs offer merchants a platform that immediately gives access to payment methods in a variety of currencies. Any payment for a good/service of an associated webshop is initially transferred to the E-Commerce Platform; the same applies to PSPs and PFs. The E-Commerce Platform commits to transfer any funds collected on behalf of the associated webshops, within a contractually agreed time frame and after deduction of a commission fee. Most PSPs offer net settlement, where the transaction fees of the payment method supplier, their buy-rate and their margin are deducted. Said funds are administered via an internal account structure in the name of the associated webshop, comparable to virtual accounts held by PSPs/PFs and e-wallets held by e-money issuers for merchants. Despite a perfect resemblance to the services offered by licensed payment institutions, the classification of payment transactions handled by E-Commerce Platforms remains unclear. In our view, these E-Commerce Platforms undeniably execute payment transactions.

Conclusion

It is one of the FSA's key objectives to be market-driven. Laws are not supposed to limit the competitiveness of the Dutch financial services sector on a national and/or international level. It is important to guarantee a level playing field, which means that similar cases should be judged and regulated in a similar manner, as proclaimed by the Dutch State Secretary of Social Affairs and Employment[6]. This is most certainly not achieved under the current regime and rulings by the DCB. Even if the discussed arguments can be countered and regulators are able to successfully claim that a store-within-a-store platform or an e-marketplace does not provide payment services and is therefore not a payment institution, key issues remain unsolved. Even if this holds ground, one is confronted with the prohibition on attracting, receiving and/or holding repayable funds. At least, the funds collected by these E-Commerce Platforms should be considered repayable funds. Simply determining that an intermediary E-Commerce Platform, which temporarily holds funds for consequent payment to the beneficiary, does not constitute repayable funds is not enough. Currently, a payment made to an intermediary store-within-a-store platform and/or e-marketplaces with the intent to achieve the purchase of a good/service, is subsequently transferred as continued payment to the webshop, which sells the purchased good/service. In our view, this constitutes the definition of a payment service. A reconsideration by the DCB of its current definitions is required.

The bankruptcy of a store-within-a-store platform and/or e-marketplace will have major consequences for the associated webshops/sellers. Do these webshops know that their funds will be claimed as part of the bankruptcy estate of the associated E-Commerce Platform? Currently, E-Commerce Platforms do not offer financial guarantees, nor do they safeguard funds. This undesirable situation can be solved if regulators acknowledge that these E-Commerce Platforms handle payment transactions and that their services, including the collection of funds on behalf of a third party, are indeed core payment services. In September 2015, the EC announced its intention to commence a public consultation on online platforms[7]. Its definition of online platforms[8] clearly includes store-within-a-store platforms and e-marketplaces. Our hope is that this consultation will mark the end of the exclusion of E-Commerce Platforms from licensing requirements and the end of the current unlevelled playing field, and that this will put an end to the risks posed by store-within-a-store platforms and e-marketplaces for their associated webshops.

Hester Bais Attorney
Bais Legal, The Netherlands
Nadja van der Veer Co-Founder
PaymentCounsel,The Netherlands
hester.bais@baislegal.nl
nadja@paymentcounsel.com

1. http://www.toezicht.dnb.nl/3/50-228841.jsp
2. http://www.toezicht.dnb.nl/en/2/51-228409.jsp
3. In the Netherlands: Article 1:5a, paragraph 2, sub b Dutch Financial Supervision Act. http://www.toezicht.dnb.nl/en/2/51-228419.jsp
4. Study on the impact of Directive 2007/64/EC on payments services in the internal market and on the application of the Regulation (EC) No 924/2009 on cross-border payments in the community.
5. EPIF Position on the Revised Payment Service Directive, 15 April 2014, http://www.paymentinstitutions.eu/documents/download/31/attachement/epif-position-paper-on-psd2-april-2014-website.pdf
6. Letter to the House of Representatives of the Netherlands, 29 January 2003 ('Kamerstuk' 28 122, nr. 11) https://www.parlementairemonitor.nl/9353000/1/j9vvij5epmj1ey0/vi3al1ra08za
7. https://ec.europa.eu/digital-agenda/en/news/public-consultation-regulatory-environment-platforms-online-intermediaries-data-and-cloud
8. An online platform is 'a firm operating in two (or multi-)sided markets, which uses the Internet to enable interactions between two or more distinct but interdependent groups of users so as to generate value for at least one of the groups.'