EMERGING PAYMENTS ASSOCIATION

Emerging Payments Association Response - Coronavirus and safeguarding customers' funds: proposed guidance for payment firms by the FCA

About the Emerging Payments Association

The Emerging Payments Association (EPA) is a commercial membership association of payments industry influencers.

It runs more than 70 events each year, delivers eight projects to drive change, helps to connect the ecosystem, encourages innovation and profitable business growth.

The EPA's vision is for the UK to be the global hotspot for payments innovation. As it sets out to be the most influential trade body in emerging payments, the EPA's mission, to collaborate to innovate, has the potential to improve lives everywhere.

Its community is over 130 members strong and growing. Our members come from across the payments value chain; including payments schemes, banks and issuers, merchant acquirers, PSPs, retailers, and more. These companies have come together, from across the UK and internationally, to join our association, collaborate, and speak with a unified voice.

Together, transacting more than £6 trillion annually and employing more than 300,000 staff, we now have a significant influence over the industry's future.

General Comments

The comments below reflect views expressed by our membership in response to the consultation on draft guidance published by the Financial Conduct Authority on 22 May.

We note our disappointment that the guidance is subject to an exceptionally short consultation window that curtails our opportunity to understand and assess the implications, especially considering that with the COVID-19 crisis, firms may have to prioritise their focus and resources on other activities.

Further, we note, even as we draft our own response to the consultation, that the issues are multi-faceted and difficult to communicate clearly. We therefore strongly recommend that:

1. you allow us the opportunity to discuss the issues further in person/via webconferencing before finalising your guidance; and
2. when your position is finalised, you communicate to firms via a webinar in which real life scenarios can be explored.

Q1 'Do you agree that we should provide additional guidance on safeguarding, managing prudential risk, and wind-down plans? If not, please explain why.'

1.1 We welcome additional guidance on safeguarding. Our members have previously and consistently called for greater clarity on the FCA's guidance and have highlighted the difficulties with both the legislative and regulatory approach.

1.2 We note our disappointment that the proposed guidance:

- does not tackle some of the issues previously raised; and
- it causes a number of concerns, as outlined below.

1.3 It is not clear whether the intention is that the temporary guidance will only be in place during the period of the pandemic crisis or beyond.

Q2 'Do you agree with our proposed guidance on safeguarding? If not, please explain why.'

2.1 The legal basis for the trust relationship referenced in the letter is unclear.

The template acknowledgment letter (to be obtained from the safeguarding credit institution or custodian) states that the firm holds 'all [money/assets] standing to the credit of the Safeguarding Account in [firm's] capacity as a trustee under the laws applicable to [the firm].'

We take it the rationale for this statement is the FCA's view that 'regulation 21 of the EMRs and regulation 23 of the PSRs implicitly give e-money holders and payment service users a beneficial interest in the funds in the safeguarding account'.

We believe the legal basis for the trust relationship implied in the safeguarding acknowledgement letter is not clear and, consequently, PIs and EMIs are not able to adequately anticipate, assess and prepare for any legal implications arising from such purported trust relationship.

Unlike the statutory trusts arising under CASS rules (see CASS 5.3.2R) which creates a fiduciary relationship between the firm and its client under which client money is in the legal ownership of the firm but remains in the beneficial ownership of the client, there is no equivalent specific rule which creates a fiduciary relationship between EMIs and PIs and their customers with respect to relevant funds. We note that EMRs and PSRs are silent on such fiduciary relationship arising, which was sometimes understood to be a deliberate choice by the legislators.

In the absence of such specific rules, the legal consequences of implying a trust relationship on top of the statutory segregation and safeguarding requirements in the EMRs and PSRs are also not clear. Examples of some of the potential areas of uncertainty are whether this introduces changes to how the relationship has to be recorded or disclosed (e.g. in the framework contract) to the customers of EMIs and PIs and the legal implications on the rights

in relation to the safeguarded funds (e.g. in the interest on the funds held in a safeguarding account), including in an insolvency situation.

Members are concerned that the change may prompt some safeguarding account providers to require additional due diligence to be undertaken on the PI/EMI and the underlying clients (beneficiaries) in order to fulfil associated obligations applicable to trusts. This may have the unintended consequence that the commercial arrangements become unattractive to the safeguarding account providers who may withdraw from the sector.

The new guidance on funds held in the safeguarding account by EMIs/PIs being held on a trust basis potentially marks a significant departure from the current understanding in the industry and has been put forward without rationale or analysis of the likely impact.

In particular, it is not clear how the concept of the trust relationship may impact the safeguarding arrangements where safeguarding accounts are held with providers in jurisdictions that do not have an equivalent or easily comparable trust concept.

Given the lack of clarity in the potential consequences of implying that such trust relationship exits, we strongly recommend that the proposed change should rather come in the form of a legislative change, or, at the very least, be preceded by a longer prior consultation period allowing firms an adequate opportunity to discuss and understand the legal implications of such proposed change.

At the very least, firms should not be expected to use the template letter or be given the freedom to alter it so that it accurately reflects specific circumstances.

2.2 Use of funds for settlement to card schemes

The FCA's new guidance proposes that EMIs should not treat relevant funds they are required to safeguard as being available to meet the commitments it has to a card scheme or another third party to settle these payment transactions. It appears the intention is that this only applies with respect to payment transactions the EMI permits its customers to make using e-money before the customer's funds are credited to the EMI's payment account or are otherwise made available to it. The guidance should reflect it is limited to such (and no other) payment transactions.

2.3 When the safeguarding obligation ends

Members have previously requested that the FCA clarifies the guidance given in paragraph 10.27 of the approach document and by FCA personnel to individual firms about when the obligation to safeguard ends. The FCA has told some firms that the obligation to safeguard doesn't end when the funds are paid out to the payee or the payee's PSP but rather when the money has been received by the customer.

This interpretation is at odds with the FCA's guidance in the approach document and is an illogical and impractical approach.

When a payment or e-money institution instructs a transfer from their bank to the PSP of the beneficiary (i.e. not another PSP acting for the institution nor the bank of its agent), until the point that the transfer is effected, as a matter of logic either (a) the institution is no longer holding relevant funds at all (so that logically the safeguarding obligation no longer applies) or (b) the institution's holding is still represented by a right against the institution's bank in respect of the account from which the money is being transferred. If that account is a safeguarding account, then the institution is continuing to safeguard money because the relevant funds should still be considered to be within the safeguarding account.

Further, the reference to the possibility that the second PSP in a chain of PSPs can safeguard on behalf the first PSP is widely understood in the industry as being a possibility, whereas it is our understanding that under the UK's insolvency legislation this is not possible.

Given the objective of the payment services and e-money directives is to open the payments market to competition, it is disappointing that the effect of the lack of clarity on when the safeguarding obligation ends results in double- or triple-safeguarding, which is a disproportionately costly outcome that is unsustainable. Members take the view that this aspect could be rectified by amendments to the insolvency legislation so that a wholesale non-bank institution can safeguard on behalf of another institution for the benefit of the other institution's clients.

It would be helpful if the FCA would clarify their understanding on these issues to the wider industry because we are very concerned that guidance is being given on a firm-by-firm basis which leaves others uninformed about the latest FAC approach.

2.4 Unallocated funds

Members note that the new requirement to place unallocated funds into a separate bank account will be difficult to comply with quickly and may be expensive where accounts in every currency will be necessary. The value of the new requirement may be outweighed by the cost, particularly if some or many of the accounts are rarely used.

2.5 Insurance

Under the PSRs, a UK payment institution has the choice to either segregate relevant funds or to ensure that such funds are covered by an insurance policy. Payment institutions using the segregation method are required to safeguard user funds that remain unpaid at the end of the day following the day of the transaction. Those payment institutions that opt for the insurance method are required to ensure the relevant policy or guarantee covers all "relevant funds", i.e. all unpaid user funds including those that are not yet unpaid at the end of the day following send. This means the amount to be safeguarded under the insurance method is greater than the amount to be safeguarded under the segregation method, which creates an inefficiency for the payment institution. This differs from the requirement of the second Payment Services Directive ('PSD2'), which instead defines users' funds requiring safeguarding under the insurance method as an amount equal to the amount that would

have been segregated if the segregation method had been used. We ask that the FCA strongly consider revising this to make the calculation of user funds requiring safeguarding consistent with Article 10 of PSD2. By creating one consistent definition of user funds requiring safeguarding for all applicable safeguarding methods in the UK, this would eliminate the inefficiency of using the insurance method.

Q3 'Do you agree with our proposed guidance on managing prudential risk? If not, please explain why.'

3.1 Members believe that the new requirement that firms deduct assets representing intra-group receivables from their own funds from the regulatory capital calculation is a significant and disproportionate change in approach.

It disadvantages UK PIs and EMIs compared to those operating in the EEA and it is not clear whether allowances will be made where other members of the group are in different markets/sectors and/or subject to their own regulatory capital requirements.
If formalised in guidance, the FCA should note that it is likely to be complex and time consuming for firms to put alternative arrangements in place.

3.2 It would be helpful if the FCA would elaborate on what they would expect the firms to have in place to determine whether intra-group liquidity facilities are 'committed' (and so can be included in assessing whether firms have adequate resources in place to cover the liquidity risk to which they are exposed).

Q4 'Do you agree with our proposed guidance on wind-down plans? If not, please explain why.'

4.1 Members seek further clarity on what is expected in the wind-down plan given the relative simplicity of many of the business models involved and that this is a new focus for the sector.

If you require further information or comment on any of our responses, please contact Tom Brewin, Projects Manager, Emerging Payments Association, tom.brewin@emergingpayments.org.