

Legal & Regulatory Working Group

Payments Innovation Forum (PIF) 2024



Competition Law Notice

Meeting participants are reminded that this meeting must adhere to competition law rules and as such no confidential or commercially sensitive information must be shared directly or indirectly between competitors.

Please do not share any confidential or commercially sensitive information and please do not ask questions that could lead to other participants to sharing confidential or commercially sensitive information about their organisation.

A written agenda has been circulated in advance and all discussion must keep to the agenda.

Please read our **Competition Law Guidelines** for further information:

[Competition Law Guidelines - Payments Innovation Forum](#)

Agenda – 24 October

1. FCA Changes to the safeguarding regime for payments and e-money firms – Key Considerations
2. US Regulatory Outlook – Ben Jackson, CCO, Innovative Payments Association, USA
3. A.O.B.

1. FCA proposed changes to the safeguarding regime for payments and e-money firms

Member Resources:

[cp24-20.pdf \(SECURED\) \(fca.org.uk\)](#)

Consultation Closes: **17 December 2024**

FCA changes to the safeguarding regime

Consumer harms and weaknesses in the current safeguarding approach the changes intend to address

- Sector growth and **increasing reliance on e-money funds**, particularly by **vulnerable consumers**:
 - The payments and e-money sector is characterised by more complex businesses and the proportion of consumers using an e-money account has consistently grown, from 1% in 2017 to 7% in 2022 → approximately 1 in 10 e-money consumers are using their accounts as their main account. The FCA maintains that this growth means that a **greater proportion of the UK population is likely to be exposed to harm** if there is a shortfall in safeguarded funds, or a delay in their return to consumers.
 - Consumer harm could be widespread if a large firm with poor safeguarding practices failed → the FCA is concerned that this could cause wider market harm if the firm held funds on behalf of another regulated firm, which in turn could see those firms fail.
 - The FCA is especially concerned about the risks of harm to vulnerable consumers – the FCA Financial Lives 2022 survey showed **40% of e-money account holders had at least one characteristic of vulnerability** – these consumers are more likely to rely on e-money funds for everyday transactions, bill payments, accessing salaries etc.
 - If a firm's UK safeguarding bank were to fail, the FSCS may be able to 'look-through' the firm to compensate its customers, but **FCSC does not apply where the firm itself fails**.

FCA changes to the safeguarding regime

Consumer harms and weaknesses in the current safeguarding approach the changes intend to address - continued

- Legal uncertainty following the **Ipagoo** insolvency
 - The Court of Appeal judgement rules that the EMRs do not create a statutory trust over funds received from e-money holders. The Court also rules that when there is a shortfall in an EMI's asset pool, it should be topped-up.
 - The FCA maintains that the judgement '*left many questions unanswered as to the status of safeguarded funds on insolvency*', e.g., uncertainty as to how the 'top-up' should rank against claims of other creditors. There are also, contrary to a trust, **no well-established legal principles** that can be easily applied to deal with questions that arise in the distribution process → IPs have continued to seek directions from the Court on the treatment of the safeguarded asset pool, leading to delays in returning funds to consumers and higher costs.
 - A subsequent Court judgement following the Allied Wallet insolvency ruled that the Ipagoo judgement extends to the PSRs, which means that relevant funds held with firms regulated under the PSRs are also not subject to a statutory trust, '*creating similar issues of legal ambiguity*'.

FCA changes to the safeguarding regime

Consumer harms and weaknesses in the current safeguarding approach the changes intend to address - continued

▪ **Poor safeguarding practices and limited regulatory oversight:**

- The FCA is concerned that many firms do not have sufficiently robust safeguarding practices and there is insufficient detail in the requirements to ensure consistent standards across the industry, help firms implement the requirements in a way that achieves intended outcomes, or provide adequate data for the FCA to monitor firms' safeguarding arrangements.
- The FCA sees shortcomings such as **1)** lack of documented processes for consistently identifying which funds must be safeguarded; **2)** inadequate reconciliation procedures, and **3)** a lack of due diligence and acknowledgement of segregation from credit institutions providing safeguarding accounts
- FCA guidance is inconsistently applied, and firms have requested additional clarity on e.g., the approach to carrying out reconciliations.
- Current regulatory reporting on safeguarded funds is limited, reducing the FCA's ability to effectively supervise firms, e.g., the FCA does not receive sufficient or timely data about the volumes of safeguarded funds or where they are held. Further, infrequent and light touch regulatory reports limits the FCA's ability to quantify and assess the risk where a firm fails or is at risk of failing.

FCA changes to the safeguarding regime

Outcome the FCA is seeking

- The risks of consumer harm the FCA has identified also exist in sectors where the CASS regime currently applies. The CASS regime is '*well established*' and currently applies to around 3,500 firms (e.g., investment firms, debt management firms, general insurance intermediaries, claims management companies) collectively holding £18 trillion of custody assets and £183 billion of client money. The FCA states that the CASS regime has strengthened over the last 20 years and is '*a good framework to draw on*' in designing the proposed safeguarding requirements.
- The FCA has adapted the existing approaches in the CASS rules to reflect payment services.
- The FCA seeks to address weaknesses in the current safeguarding regime and ensure customer money is safe by:
 - Minimising shortfalls in safeguarded relevant funds
 - Ensuring funds are returned as quickly and as cost-effectively as possible
 - Strengthening the FCA's ability to identify and intervene in firms that do not meet the safeguarding expectations.

FCA changes to the safeguarding regime

Summary of proposed changes:

The FCA proposes to bring in the new obligations in **two stages**. The obligations will be added to the CASS and SUP chapters of the FCA Handbook.

- In the **interim-state**, which the FCA proposes to introduce **in advance of legislative change**, the **proposed rules** will supplement the current safeguarding requirements in the PSRs and EMRs:
 - More detailed record-keeping and reconciliation requirements – similar to existing requirements set out in CASS 7 for investment firms, and a requirement to maintain a resolution pack, including requirements on the types of documents and records to be included;
 - Requirement to complete a new monthly regulatory return covering safeguarded funds and safeguarding arrangements. The interim-state also introduces a new annual audit requirement, and a requirement to allocate oversight of compliance with the safeguarding requirements to an individual in the firm.
 - Additional safeguards where firms invest relevant funds in secure liquid assets, and requirements to consider diversification of third parties with which firms hold, deposit, insure or guarantee relevant funds that it is required to safeguard and due diligence requirements. There will also be additional safeguards and more detailed requirements on how firms can safeguard relevant funds by insurance or comparable guarantee.

FCA changes to the safeguarding regime

Consultation Questions:

- Do you agree with the proposed rules and guidance on record-keeping, reconciliation of relevant funds and the resolution pack in both the interim and end state? If not, please explain why.
- To what extent will firms incur operational costs relating to record keeping, reconciliation and resolution packs when moving from the interim to end state?
- Do you agree with the proposals for requiring external safeguarding audits to be carried out in both the interim and end state? If not, why not?
- Do you agree with the proposals to require that safeguarding audits are submitted to the FCA? If not, why not?
- Do you agree that small EMI's should be required to carry out an annual safeguarding audit? If not, why not?
- Do you agree with the proposals for safeguarding returns to be submitted to the FCA and the frequency of reporting, in both the interim and end state? If not, please explain why.
- Do you agree with the proposed data items to be included in the report? If not, please explain why.
- Do you agree with the proposals to make prescriptive rules on the segregation of relevant funds in both the interim and end state? If not, please explain why.
- Do you agree with our proposals to require relevant funds to be received directly into a designated safeguarding account subject to specified exceptions? If not, please explain why.

FCA changes to the safeguarding regime

Consultation Questions - continued:

- Do you agree that funds received through agents or distributors should either be paid directly into the principal firm's designated safeguarding account, or protected through agent and distributor segregation? If not, please explain why.
- Do you agree that firms should be able to invest in the same range of secure liquid assets as they can now in the interim state? If not, please explain why.
- Do you agree that firms should continue to be able to invest relevant funds in secure liquid assets in the end state? If not, please explain why.
- Do you agree that Payments Firms should be able to hold the assets they invest in, or should they always be held by a custodian? If you disagree that Payment Firms should be able to hold the assets they invest in, please explain why.
- Do you agree with our proposals to maintain the use of insurance policies and comparable guarantee for safeguarding in both the interim and end state? If not, please explain why.
- Do you agree that the use of insurance policies and guarantees leads to the risks identified above? Are there other risks of which you are aware? Please explain your answer.
- Do you agree that a statutory trust is the best replacement for the safeguarding regime in the EMRs and PSRs? If not, please explain why.
- Do you agree with the proposed terms of the trust, including the Payments Firm's interest after all valid claims and costs have been met? If not, please explain why.

FCA changes to the safeguarding regime

Consultation Questions - continued:

- Do you agree with our proposals to clarify when the safeguarding requirement starts and ends? If not, please explain why.
- Do you agree that the implementation arrangements give Payments Firms sufficient time to prepare for the interim and end-state rules coming into force? If not, please explain why.
- Do you agree that the transitional provisions are appropriate? If not, please explain why.
- Do you consider that any other transitional provisions are needed? If so, please explain why.

FCA changes to the safeguarding regime

Key Considerations from a PIF perspective:

- PIF supports the regulatory goal to increase consumer protection and reduce contagion risk should a firm fail, but **to what extent do the proposals actually make tangible steps to meeting those aims?**
- The multi-phase process the FCA wants to implement has risk attached to it. There will be at least two consultations, but some of the text in the consultation paper suggests there might also be a third. **Might it be better to delay phase 1 and consult/implement just once?**
- There are a number of moving parts: some of the draft text is to be inserted a later date, so some aspects of the consultation cannot be fully opined on. There will also need to be legislative changes to the PSRs and EMRs; plus – it appears that PESAR (Payments and Electronic Money Special Administration Regime) is to be amended as well. **Consequences of those future changes may impact what we consider now.**
- The **Cost Benefit Analysis** seems woefully underestimated. It would be helpful if members could estimate the costs associated with similar regulatory changes. Linked to this, it feels like more time ought to be given to implementation, especially if this is to be multi-stage, and especially given the recent experience of the APP scams reimbursement requirement.
- **Is a Statutory Trust really needed?** Can the aims be met in other ways? Has the FCA fully thought through the implications of a trust being created and fiduciary duties being owed? Trust or no trust, if a non-compliant firm simply does not put funds that should have been deposited into a safeguarding account, the problem still exists.
- The role of senior individuals will be changing, but it is not clear what additional liability they will owe.

FCA changes to the safeguarding regime

Key Considerations from a PIF perspective - continued:

- **Is a CASS-style regime appropriate for all firms?** To what extent is a regime suited to investment and insurance activities compatible with the speed and complexity of payment processing? How will impact the concept of e-money as a distinct regulated activity?
- Using the segregation method means ALL monies going into a designated safeguarding account – how easy will it be for firms to implement a system to take out non-relevant funds from the DSA as quickly as possible, and what will the costs be?
- For firms with agents and distributors, they will essentially need to put their own money into a safeguarding account → it is not clear how this would work in practice. **Some firms may go out of business** if they always need to put aside a large sum of its own money.
- **What will be the impact on members' relationship with their safeguarding banks?** Will it make things more difficult? The FCA recognises firms' difficulty in obtaining and maintaining a safeguarding account, but also says that firms may rely on safeguarding through investing in secure liquid assets. Even for that method, there is still a need for a safeguarding account → this does not solve the problem.

2. US Regulatory Roundup

3. A.O.B