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 – 14 November 2024

1. FCA Changes to the Safeguarding Regime for Payments and E-money firms: Key issues
    a) Cost benefit analysis
    b) Holding of funds under statutory trust
    c) Enhanced monitoring and reporting requirements – Audit
    d) Business Models
2. A.O.B.

1. Changes to the Safeguarding Regime: Key Issues

Changes to the Safeguarding Regime: Key Issues

Overarching Issues

- We generally support the interim rules – to ensure that firms have adequate policies and procedures in place to meet the safeguarding requirements set out in the EMRs and PSRs. However, **we do not believe that the proposed changes address the risks** identified with the current regime:

  → The proposed changes will not address delays in returning funds to customers in the event a firm becomes insolvent. While the Ipagoo case may have created legal uncertainty as to the status of safeguarded funds on insolvency, our view is that Ipagoo simply failed to comply with the safeguarding requirements. **Trust or no trust, the problem still exists.**

  → The changes do not adequately address firms' access to safeguarding accounts. The FCA acknowledges that *"some firms continue to experience difficulties accessing safeguarding accounts with credit institutions"* but goes on to say *that "firms may rely more on safeguarding through investing in secure liquid assets".* **This does not in any way address the difficulties faced by firms** because even this safeguarding method requires a safeguarding account.

  → The FCA says it has *"limited regulatory oversight"* due to inadequate access to data about the volumes of safeguarded funds and where they are held. Whilst the interim rules rightly aim to strengthen the FCA's ability to identify and intervene against payments firms that do not meet the requirements, we believe that **non-compliance is a matter for FCA supervision/enforcement, not the basis for a wholesale change in rules**.

Changes to the Safeguarding Regime: Key Issues

Cost Benefit Analysis (CBA)

- **The cost benefit analysis is underestimated and is not realistic**. It is based on some major assumptions that are flawed:

    1. It assumes that compliance with the current safeguarding requirements is 100%. The FCA's rationale is that if it does not use 100% as a baseline, that would increase the cost of introducing the new rules and non-compliant firms would benefit (i.e., if no new rules are introduced, non-compliant firms would not need to comply with the new rules). However, when assessing the benefits, the FCA seems to drop the compliance assumption and instead refers to current estimated shortfall in safeguarded funds (i.e. non-compliance). This is questionable because if 100% compliance is assumed on the cost side then 100% should also be assumed on the benefit side, to ensure a level playing field.
    2. The CBA also **assumes payment firms will be able to find safeguarding banks**, which is a significant flaw. Also, the cost assessed on this point **refers only to staff salaries** – it does not take to into account, e.g., the cost of posting collateral demanded by safeguarding banks, or managing the risks or consequence of safeguarding banks pulling out of an arrangement.

- Further, when the FCA refers to "Familiarisation and gap analysis", the FCA assumes an 80-page policy document that **would take compliance staff 4 hours "to read"** (assuming 300 words per page and a reading speed of 100 words per minute). This seems too simplistic as such an **analysis requires more than just "reading" a policy document.**
- On the cost side, the CBA overlooks payment firms having to place their own money into the safeguarding account (e.g., in an agents and distributors scenario).

Changes to the Safeguarding Regime: Key Issues

Cost Benefit Analysis (CBA) - continued

- **For consideration: Costs to Clients**
  - The FCA acknowledges that any costs incurred by firms *"may ultimately be passed on to clients through higher fees and charges",* but believes significant cost increases are unlikely as payments firms face competitive constraints from other firms not affected by the rules (e.g. retail banks)
  - The FCA does not expect a material number of clients will face issues finding alternative providers in the event the proposed changes threaten the commercial viability of a product or service, *"given the large number of active payment firms, and that retail banks also offer such services"*

Changes to the Safeguarding Regime: Key Issues

Statutory Trust

- The FCA believes that a statutory trust is the **only way to eliminate the Ipagoo case risk**. *[note: the UK Court judgement ruled that neither the EMRs or PSRs create a statutory trust over safeguarded funds].* The proposed changes are highly unlikely to address delays in returning funds to customers in the event a firm becomes insolvent.
- While the Ipagoo case may have created legal uncertainty as to the status of safeguarded funds on insolvency, our view is that **Ipagoo simply failed to comply with the safeguarding requirements**. Even with a statutory trust over safeguarded funds, the insolvency practitioner would still need to identify those who are owed money which would still take time and come at a significant cost. Trust or no trust, **if a firm fails to put money that should have been deposited into the safeguarding account, the problem still exists**. Non-compliance should be a matter for FCA supervision/enforcement, not the basis for a wholesale change of the rules.
- Further, a statutory trust over funds received by EMIs in exchange for issued e-money would run against the legal nature of e-money issuance, which involves a 1:1 exchange of monetary value and a consequent transfer of title. EMIs offer users no further services in relation to the price paid for the e-money, and the redemption right attached to e-money does not give rise to a proprietary right in the safeguarded funds. Nor is e-money a collective investment scheme. Applying a statutory trust to safeguarded funds would fundamentally change the legal nature of e-money.

Changes to the Safeguarding Regime: Key Issues

Enhanced Monitoring and Reporting Requirements - Statutory Audit

- The CBA assumes that firms' safeguarding audits will cost £12K/year for a small firm, £100K/year for a medium firm and £200K/year for a large firm. This is **exorbitantly higher** than the £6K-£21K medium and large firms are currently paying. The CBA appears to be based on the pricing of 'Big 4' firms as opposed to payments auditors.
- Firms' compliance with the statutory audit requirement would exceed the auditing industry's already limited capacity, resulting in sub-standard audits being carried out by auditing staff with insufficient experience to adequately assess a firm. Sole use of statutory auditors may lead to regulated entities being given incorrect or misguided recommendations based on their audit, if the audit firm has limited safeguarding knowledge. **This will have a significant cost impact on firms**.
- Further, the number of daily reconciliations would multiply, in some cases by more than a hundred-fold. This cost will be a permanent increase to firms' operational costs, additional to the significant one-off operational costs that will be incurred by re-designing payment flows to meet the new CASS-style requirements. [*The FCA does not anticipate there to be material changes to current expectations on firms and, consequently, "no additional costs will be incurred" – in respect of record keeping and reconciliations*]
- Compared to what are likely to be the limited benefits of the new regime, it is questionable whether these costs will be justified, given the negative impact that these platform changes would have on firms' ability to innovate/bring new products to market.

Changes to the Safeguarding Regime: Key Issues

Business Models

- The consultation does not address different business models in the sector, resulting in continued inconsistency in which funds are considered relevant under different models. This not only creates uncertainty for consumers (funds protected in one firm, but not in another) but also adds significant legal costs in the event of liquidation, materially reducing funds that will be available for distribution.
- This is particularly an issue where business models are more complex, e.g. FX

Changes to the Safeguarding Regime: Key Issues

Next Steps

- **PIF/FCA engagement:**
  - Joint trade association (PIF, EMA, AFEP, PA) letter – 15 November
  - FCA/TA follow up meeting – 21 November
  - FCA/TA roundtable – 26 November

PIF Member feedback by 30 November:

  - What are members' views on the key issues we have raised, in particular the cost benefit analysis and audit requirement?
  - Are there other aspects of the proposed changes members are concerned or unsure about?
  - Anonymous member feedback form: https://forms.gle/dqSQehEEGtABHbJ27

Additional Resources:

- **London Governance & Compliance Academy Webinar** – Safeguarding in the Financial Services Sector – 20 November from 12:00-1:00pm

2. A.O.B.