HM Treasury

Insolvency changes for payment and electronic money institutions:

response to consultation

April 2021

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Chapter 1

Introduction

1.1 In December 2020, HM Treasury published the consultation document, 'Insolvency changes for payment and electronic money institutions'. The consultation document sought views on insolvency changes proposed for payments institutions and electronic money institutions (PIs/EMIs), including the introduction of a new special administration regime for PIs/EMIs (pSAR).

1.2 We consulted on the following key areas related to the legislation:

- Scope and objectives
- Return of customer funds in insolvency
- Transfer provisions
- Part 24 of the Financial Services and Markets Act 2000 (FSMA)

1.3 The consultation ran from 3 December 2020 to 21 January 2021, during which time the Government received 15 written responses (see Annex A for a list of respondents). In response to feedback about the length of the consultation period we extended the consultation period by an additional week. This document summarises the responses received from the consultation, sets out the Government's response to the issues raised, and provides an update on the forthcoming legislation.

Insolvency changes for payment and electronic money institutions

1.4 Payments in the UK have seen rapid change over recent years with people increasingly using card, mobile and electronic wallets to make payments. These changes offer opportunities for UK businesses and consumers, with many making payments faster, cheaper and more securely. However, and as will always be the case with a rapidly changing technological landscape, they also present new challenges and risks.

1.5 The PIs/EMIs providing these services have diverse business models that range from small money remittance firms to non-bank current account providers targeting SMEs, the underbanked and the digital generation. Consumers and businesses are increasingly using PIs/EMIs as their transactional banking providers to, among other things, access their salaries and savings as well as make payments.

1.6 Given the pace of change, an HM Treasury-led Payments Landscape Review was announced in June 2019. As a first part of this Review, a Call for Evidence was launched, which asked questions about the opportunities,

gaps and risks that need to be addressed to ensure that the UK remains at the cutting edge of payments technology. This Call for Evidence closed on 20 October 2020 and the Government is now considering the responses and will publish its response in due course.

1.7 However, there is evidence that the existing insolvency process for PIs/EMIs is suboptimal with regards to consumers. Recent administration cases involving PIs/EMIs have taken years to resolve in some cases, with customers left without access to their money for prolonged periods and receiving reduced monies after the cost of distribution.

1.8 We are therefore proposing to introduce changes that will help protect customers in the event of a PI/EMI being put into insolvency. As these changes can be delivered relatively quickly and could mitigate harms from any future insolvencies, it is therefore appropriate to progress these changes before the conclusion of the Payments Landscape Review is published. This will in turn strengthen confidence in the payment and e-money sectors by improving customer and market outcomes.

1.9 To address the shortcomings of the current insolvency regime for PIs/EMIs, we propose introducing a pSAR which will have the following key features:

- an explicit objective on the special administrator to return customer funds as soon as reasonably practicable
- a bar date for client claims to be submitted to speed up the distribution process
- a mechanism to facilitate the transfer of customer funds to a solvent institution
- a post-administration reconciliation to top-up or drawdown funds to or from the safeguarding process (where appropriate)
- provisions for continuity of supply to minimise disruption
- rules for treatment of shortfalls in the institution's safeguarding accounts
- rules for allocation of costs
- an explicit objective on the special administrator for timely engagement with payment systems operators and authorities

1.10 The FSMA Part 24 provisions provide the Financial Conduct Authority (FCA) with specific powers to protect consumers in an insolvency process of an FCA authorised firm. While the Electronic Money Regulations 2011 (EMRs) and Payment Services Regulations 2017 (PSRs) incorporate some FSMA insolvency provisions, we propose extending the full suite of provisions to PIs/EMIs so that the FCA has the same rights to participate and protect consumers in an insolvency process as it does for other FCA supervised firms.

1.11 Subject to certain exclusions, the proposed pSAR would be available to all PIs/EMIs, by reference to the PSRs and EMRs respectively. The scope of the proposed application of FSMA Part 24 provisions would be to all PIs/EMIs entering standard insolvency processes.

1.12 Due to differences in aspects of insolvency law in Scotland and Northern Ireland, we have judged that further work is required before the pSAR can be appropriately applied to firms in Northern Ireland and to Partnerships and Limited Liability Partnerships (LLPs) in Scotland.

1.13 We believe that delivering these reforms now and then legislating as soon as practicable to expand eligibility to these firms in Northern Ireland and Scotland is the best option for consumers in Scotland, Northern Ireland and across the UK. The FSMA provisions will still apply to all PIs and EMIs in Scotland and Northern Ireland, and the new SAR will apply to all PIs and EMIs in Scotland that are not registered as Partnerships or LLPs. This means that all customers of firms registered in England, Wales and Scotland (covering 99% of firms across the UK) will receive these additional protections no matter where in the UK those consumers are based.

Chapter 2

Summary of responses

2.1 The Government received 15 written responses to the consultation. The consultation asked 4 questions, the responses to which are summarised below, as well as summarising additional areas raised in the consultation responses.

Question 1: Do you have any comments on the proposal to introduce a Special Administration Regime for Electronic Money and Payment Institutions?

2.2 All respondents answered this question and most expressed support for the proposals, noting that using the Investment Bank Special Administration Regime (IBSAR) as a model should help reduce the cost and time of returning funds to customers.

2.3 However, one respondent thought the introduction of a pSAR was unnecessary. They felt that it could lead to reduced amounts of investment available to these firms and reduced levels of competition with fewer firms providing more expensive services. Instead, they suggested that further guidance is provided for insolvency practitioners (IPs) to act with the specific objective of returning funds as soon as possible and enhanced supervision of PIs/EMIs to achieve the same goal.

2.4 Respondents raised several additional points:

- Two respondents asked that a transition period be introduced to allow firms time to make the necessary contractual changes.
- One respondent proposed a number of additional measures, including: a senior managers regime for PIs/EMIs; improved disclosure of risks to customers; and an extension of Financial Services Compensation Scheme (FSCS) coverage to PIs/EMIs.
- One respondent noted that the special administrator's powers should be used proportionately as PIs and EMIs had different risk profiles and should therefore not be treated the same.
- One respondent suggested that further consideration be given to 'in-flight payments' as, while most transactions would be protected under UK settlement finality rules, some categories may fall outside of these protections.
- One respondent flagged that payment systems operators may have conflicting objectives under the pSAR (working with the administrator whilst also protecting the interests of their other members) and asked if

further provisions could be added to provide clarity. They also commented that payment systems operators should be excluded from the continuity of supply provisions.

- A respondent noted that existing FCA safeguarding and wind-down measures should be considered alongside these regulations to ensure consistency.
- Another respondent suggested that safeguarding failures should be addressed during the execution of a firm's wind-down plan in order to preserve client funds during a special administration.

Question 2: Do you have any comments on the proposed distribution principles?

2.5 All but one respondent answered this question. The majority of respondents welcomed the framework for the distribution of customer funds.

2.6 One respondent questioned whether consumers were aware of the risks when using PIs/EMIs.

2.7 Another respondent asked for further clarity on the extent of discretion to be exercised by the administrator, and questioned whether firms would be expected to continue providing regulated services unless otherwise notified by the administrator or the FCA.

2.8 One respondent suggested that client funds should not be able to be accessed by IPs, and that instead the FCA should raise capital requirements for at-risk firms so that the IP could use capital for their expenses of administering the firm.

2.9 Respondents also asked that the pSAR regime incorporate an obligation to publicly notify when a firm entered into special administration, for example via the FCA website.

2.10 A number of respondents commented on the bar date proposals:

- Several respondents commented that these proposals may interfere with an e-money holder's rights of redemption under the EMRs. The hard bar date would allow IPs to set a final date at which customers could claim, whereas the EMRs gave consumers six years to redeem their e-money after the end of a contract.
- Multiple respondents requested safeguards for consumers regarding the setting of bar dates and other distribution mechanisms. However, other respondents noted that this should be balanced against the increased costs that stricter contact requirements would have, either for PIs/EMIs to hold more customer information or for IPs during the administration.
- One respondent expressed concern that consumers would not understand what a bar date was, and a number expressed concerns about the difficulty for IPs in contacting consumers holding gift cards or promotion programmes.
- A further response suggested that payment systems operators should be given notice of bar dates at the same time as relevant creditors. They also

commented that the regulations should make clear that settlement funds were protected and must be paid to the relevant payment system, similar to any other post-administration liability.

2.11 Some respondents stated that suppliers and account providers should not be prevented from bringing their relationship with a PI/EMI to an end if they exercised their termination rights prior to the administration.

2.12 A number of respondents had concerns that currency reconciliation was likely to increase costs for firms and recommended that customers of the insolvent PI/EMI continue to pay currency conversion fees to facilitate the return of their funds. They added that the complexity of distribution could cause difficulty with different types of accounts and currencies and suggested further consultation was held on how to address these issues.

2.13 Some respondents noted that the draft regulations quantified a customer's entitlement by reference to the amount of relevant funds which the EMI was required to safeguard. This could potentially lead to issues where the firm was safeguarding a different level of relevant funds than the customer was entitled to. For example, if funds were added to a customer's account after administration then those funds may not be included in the entitlement for that customer.

2.14 Some respondents noted the difficulties that may be faced by customers (and particularly vulnerable customers) if all transactions were to be stopped during the administration.

Question 3: Do you have any comments on the proposed transfer provisions?

2.15 The majority of respondents answered this question and most responses were supportive of the transfer proposals.

2.16 One respondent confirmed support of a simplified process to transfer customer funds. They cautioned that transfers of payments or e-money business may give rise to competition concerns given the relative market share of some financial institutions. They also recommended including set-off and netting arrangements in the regulations.

2.17 Another stated that not requiring consent from third parties should assist IPs in achieving transfers. They noted that there were still various challenges when transferring customers including: the costs of handling anti-money laundering requirements; the costs of handling unresponsive customers; General Data Protection Regulation considerations; customers having funds across multiple pools; and finding a suitable purchaser.

2.18 One respondent noted that in some cases PIs hold balances with institutions outside of the UK and retrieving funds from these firms may be time consuming as the non-UK institutions might not be regulated.

2.19 Another respondent noted that business transfers should mandatorily carry a transfer of all unpaid liabilities to the payment scheme or participants. They also wanted the regulations to be clear that mandatory transfers to a successor entity should be expressly without prejudice to the rights of

payment schemes to refuse participation status, and that a transfer should not override set-off and netting arrangements.

2.20 A further respondent expressed concern over the special administrator's powers to novate PI/EMI contracts with agents and distributors without consent. They stated that agents and distributors should be consulted and given an opportunity to present their views and/or choose the solvent PI/EMI to which the business parts they were involved with were being transferred.

Question 4: Do you have any comments on the proposal to extend the remaining provisions of Part 24 of FSMA to Electronic Money and Payment Institutions?

2.21 Most respondents did not respond to this question. Those who answered this question generally welcomed the expansion of provisions of Part 24 of FSMA to PIs/EMIs.

2.22 One respondent added that these provisions would further strengthen confidence in the sector, and another noted that a consistent approach for the handling of all FCA regulated businesses would assist IPs.

2.23 One respondent wanted greater rigour and standards from the FCA to ensure all PIs/EMIs complied properly with safeguarding and capital rules.

2.24 One respondent noted issues related to extending these provisions to firms registered in Scotland.

Additional comments

2.25 A number of additional points were made by single respondents:

- Non-corporate insolvencies in Scotland would need further consideration, as the definitions within the draft pSAR regulations excluded these firms.
- Proposals for the pSAR rules suggested that trust assets could not be subjected to a security interest. They gave an example of circumstances in which such assets could be encumbered by security rights.
- At the outset of the administration it may be unclear to what extent customers were also creditors of the firm.
- IPs may have limited options in managing the administration of a firm where there were few assets not designated as relevant funds.
- If the only funds available to the IP were the safeguarded funds, the IP would require comfort that any liability they committed to could be classified as a cost of distribution and therefore would be payable from the safeguarded funds. This may be exacerbated by the hierarchy of claims and expenses against these funds, which should be clarified.
- The proposals assumed the principles outlined in the Supercapital judgement (confirming that, in respect of a payment institution that used the segregation method of safeguarding, the PSRs create a statutory trust over relevant funds) which could change in future.

- The grounds on which a firm could be put into the pSAR are too wide, given that the regulations allow the court to put a firm into the pSAR if it would be 'fair' to do so.

2.26 There were a number of other suggestions or comments that were outside of the scope of this consultation and the regulations.

Chapter 3

Government response

3.1 The Government has carefully considered all the responses to the consultation and met with a number of respondents to further discuss their concerns. The points below reflect where changes have been made to the proposed regulations in order to take account of concerns and, for certain suggestions, provide an explanation as to why it was decided that no change was required. We have not included responses to some of the wider issues that were outside of the scope of this consultation.

Introducing a Special Administration Regime

3.2 In response to concerns around the consistency of the pSAR with new and existing FCA safeguarding and wind-down measures, we have worked closely with the FCA to ensure that these proposals are consistent with existing regulations.

3.3 In response to concerns that this regime would allow otherwise going concern firms to be unfairly put into administration, we have reviewed the drafting and relevant pieces of existing legislation to ensure that this is not the case. This regime will not allow otherwise going concern companies to be placed into administration with insubstantial reasoning. Within the regulations, specified parties can apply to the Court to place a firm into special administration if it would be fair to do so. This replicates the IBSAR regulations and gives the Court discretion to decide whether or not the firm ought to be placed into special administration.

3.4 In response to concerns that this will reduce competition in the sector, we have carefully considered the cost burdens that this will place on firms and have published a de minimis impact assessment outlining that we do not believe there will be significantly increased costs for PIs or EMIs. We consider that the suggestions for more stringent capital requirements or increased supervision of the sector lie outside of the scope of this consultation, but these may be considered in the Payments Landscape Review.

3.5 The Government consider suggestions of further measures that would more directly affect going concern firms (for example, FSCS coverage for PIs and EMIs or the senior managers regime) to be outside of the scope of this legislation.

3.6 In response to the suggestion that there should be a transition period to allow firms time to make the necessary contractual changes, we are conscious that contractual changes cannot be immediate. However, we do not believe that a statutory period would be required given that the

contractual changes expected are not complex and largely administrative. The FCA as the supervisor will have the capacity to use their judgement on this issue.

Distribution principles

3.7 In response to various concerns and suggestions raised we will introduce additional steps within the pSAR rules to:

- Require IPs to provide a reasonable notice period before a bar date comes into effect. This will allow time for IPs to communicate bar dates to customers and for customers to make claims.
- Clarify the full hierarchy of expenses.
- Require notice of a bar date to be given to all persons whom the administrator believes to have a right to assert a security interest or other entitlement over the relevant funds.
- Require the special administrator to engage closely with payment systems operators during the special administration.

3.8 In response to concerns about disruption to services, it should be noted that in certain circumstances firms will be able to continue providing regulated services once they are placed into special administration. We believe this will provide more flexibility than under the current insolvency regime.

3.9 In response to concerns that the pSAR regime should incorporate an obligation to publicly notify when a PI/EMI enters into special administration, we expect the FCA to be notified of this (given the FCA would be entitled to be heard at the court hearing of a special administration). The FCA would subsequently amend the firm's permissions on the FCA's Financial Services Register to reflect that the firm is in special administration.

3.10 In response to concerns about the continuity of supply provisions, it should be noted that the continuity of supply provisions only apply if the contractual right to terminate supply was not exercised before the special administration order is made. The restrictions would not be expected to apply if the supplier had already exercised their right to terminate prior to the special administration order being made.

3.11 We noted concerns around quantifying customer entitlements by reference to the amount of relevant funds which the EMI was required to safeguard and, in particular, the feedback suggesting customers could be deprived of their funds. However, the effect of the post-administration receipts policy is to require the special administrator to hold such funds in a relevant funds account that is separate to any relevant funds held by the firm prior to entering special administration and promptly return these to the relevant customers. If the provisions were dis-applied, this would mean mixing such post-administration receipts into the asset pool for distribution (rather than keeping these separate).

3.12 In response to concerns that currency reconciliation was likely to increase costs and that customers ought to pay exchange fees, we note that the regulations expect a special administrator to be efficient in their work and

take steps with the aim of reducing costs that would be borne by clients and creditors where possible. Consumers will continue to be bound by their contractual obligations and pay costs where appropriate.

Transfer provisions

3.13 The Government noted suggestions for inclusion and clarity on set-off and netting provisions and has amended the regulations accordingly.

3.14 In response to concerns around retrieving funds from non-UK (and potentially unregulated) institutions, we believe that this is a broader concern around safeguarding, and so is not within the scope of this consultation. The Payments Landscape Review will consider broader concerns regarding safeguarding.

3.15 In response to the suggestion that a transfer mandatorily carries a transfer of all unpaid liabilities to the payment scheme or participants, we note that this is the policy intention of the legislation and is reflected in the regulations.

3.16 In response to the concern that mandatory transfers over-ride the rights of payment schemes to refuse participation status or set-off and netting arrangements, we agree and note that the drafting of the regulations does not conflict with either of these issues.

3.17 In response to competition concerns surrounding transfers, we note that this issue could occur under the current insolvency regime, and that the Competition and Markets Authority review transfers on a case-by-case basis.

3.18 In response to concerns around finding a suitable transferee within the timescales of the pSAR, we note that the special administrator is required to perform due diligence on any transferee.

3.19 In response to concerns over the special administrator's powers to novate contracts with agents and distributors without consent, we note that under the regulations agents and distributors would be notified of the transfer and that they would still have the right to cancel the contract if they did not agree with the transfer decision.

Extension of FSMA Part 24 provisions

3.20 We have noted concerns raised around the interactions between the FSMA Part 24 provisions and Scottish insolvency law, but consider these changes to be wider than the scope of the consultation and so are investigating these issues separately.

Additional comments

3.21 We do not believe that the regulations create issues with customers of the firm in administration who are also creditors of the company. To the extent that a customer's claim is not satisfied by distributions from the asset pool, the customer can make an unsecured claim against the creditor estate (subject to insolvency rankings and allocations within the creditor estate). A customer will rank as a general creditor for this kind of claim (and therefore will not be treated differently from other creditors).

3.22 We note that it is possible in some limited circumstances for trust assets to be subject to security rights, and will seek to address this in the pSAR Rules.

3.23 The Supercapital judgment confirmed that, in respect of a payment institution that used the segregation method of safeguarding, the PSRs create a statutory trust over relevant funds. While the Supercapital judgment could be overturned in other proceedings, the judgment itself is not subject to appeal and represents the current state of the law. The regulations themselves build on the express provisions of the PSRs and EMRs that provide that in the event of insolvency, the claims of users and holders are to be paid from the asset pool(s) in priority to all other creditors (subject to certain exceptions in the PSRs/EMRs).

3.24 Similar to the IBSAR, we intend for the pSAR rules to clarify that the special administrator's remuneration and expenses incurred in respect of the pursuit of Objective 1 are to be payable out of relevant funds.

3.25 The administrator has the flexibility to prioritise objectives as appropriate in order to achieve the best result overall for users or holders and creditors. However, the pSAR contains the safeguard that the FCA (after consultation with HM Treasury and the Bank of England) has the power to direct the administrator to prioritise certain objectives over others if it is necessary to maintain the stability of the financial systems of the UK; maintain public confidence in the stability of the UK financial markets, payment systems and payment services and electronic money sectors of the UK; or secure an appropriate degree of protection for users or holders.

Chapter 4

Next steps

4.1 The Government consulted with the FCA and the Insolvency Service throughout the drafting of this legislation.

4.2 This document was published in the week that the statutory instrument containing FSMA changes and pSAR regulations was laid in Parliament. Further statutory instruments containing the pSAR rules will be laid in Parliament later this year.

Annex A

List of respondents

Association of UK Payments and FinTech Companies

Building Societies Association

Dr Alisdair MacPherson, Mrs Donna McKenzie Skene and Dr Burcu Yüksel Ripley, acting as a working group of the Centre for Commercial Law at the University of Aberdeen

Electronic Money Association

Emerging Payments Association

Financial Services Consumer Panel

KPMG Restructuring

Law Society of Scotland

Mastercard

Modulr FS Limited

Prepaid International Forum

Revolut Ltd

Transferwise

UK Finance, Allen & Overy

Wirex Limited

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