Response to FCA consultation

Coronavirus and safeguarding customers' funds

3 June 2020

COMPLIANCY SERVICES
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1. INTRODUCTION

On 22 May 2020, the Financial Conduct Authority (FCA) issued a consultation proposing additional temporary guidance to strengthen payment firms' prudential risk management and arrangements for safeguarding customers' funds, in view of the exceptional circumstances of the coronavirus pandemic (COVID-19). The proposed guidance covers:

- Safeguarding:
  - Keeping records and accounts and making reconciliations.
  - Safeguarding accounts and acknowledgment letters (including template acknowledgment letter).
  - Selecting, appointing, and reviewing third parties.
  - When the safeguarding obligation starts.
  - Unallocated funds.
  - Annual audit of compliance with safeguarding requirements.
  - Disclosing information on treatment of funds on insolvency to customers.
- Prudential risk management:
  - Governance and controls.
  - Capital adequacy.
  - Liquidity and capital stress testing.
  - Risk management arrangements.
  - Wind-down plans.

Compliancy Services is one of the UK's leading providers of regulatory compliance services to firms that provide payment services and issue e-money. Our clients range from start-ups to some of the most innovative, largest, and best-known brands and we've provided services to almost 20% of all authorised payment and e-money institutions. We understand how the proposed guidance will affect the sector and in this short document contribute to the consultation.

2. CONSULTATION QUESTIONS & RESPONSES

In this section we answer the questions posed by the FCA consultation.

2.1. Question 1

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

In our experience, particularly in respect of the Safeguarding Attestation exercise in July 2019, there are a significant number of 'atypical' business models. As a result, the current Approach Document guidance does not make it clear to all firms what is required of them. Our own advice to firms has always been that the documentation and rationale for the safeguarding method used should be clearly documented. We would therefore welcome clearer guidance on this, perhaps with worked examples to illustrate what the FCA would consider 'good' to look like.

2.2. Question 2

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

We agree with the proposed guidance but have several observations.

You offer examples of the type of non-compliance you expect to be notified about in accordance with paragraph 10.66 in the Approach Document:

- Not keeping up to date records of relevant funds and safeguarding accounts, or
- Where a firm is unable to comply due to the decision by a safeguarding credit institution to close a safeguarding account.

We would suggest that additional guidance would be helpful on what constitutes materiality in respect of an inability to reconcile balances.

We note the section on selecting, appointing, and reviewing third parties, but we would suggest that it is important to recognise the lack of opportunities to change provider. Notwithstanding the provisions of Regulation 105 in the Payment Services Regulations (PSRs), there are only a limited number of credit institutions or insurers willing to offer safeguarding accounts to payment institutions and e-money institutions.

The provision of a template letter for acknowledgment from the safeguarding credit institution or custodian is welcomed and was indeed proposed by Compliancy Services at the time of PSD2 implementation. We are, however, puzzled by the introduction of the requirement that the letter should state that the firm holds all the relevant funds or assets in the safeguarding account as trustee. It is noted that there is no reference in the PSRs to this requirement, and the only reference in the current Approach Document in in relation to safeguarding by insurance or guarantee. This raises a number of potential issues for both payment firms and banks and we would suggest that further detailed consideration of its impact should be undertaken before its introduction.

In addition, the experience of our clients using banks elsewhere in the EEA is that it is difficult to get them to provide acknowledgment letters in any form. Expecting them to provide a letter in a template required by the FCA is, unlikely, to be successful. This issue will potentially worsen post Brexit with the introduction of the ability to use banks in other OECD countries for safeguarding. We would be grateful for confirmation that the final sentence in the paragraph allowing firms to "demonstrate that the credit institution or custodian has no such interest in, recourse against, or right over the relevant funds or assets in that account" means that the use of the template letter is not mandatory.

We would, also, propose that the guidance makes clear that where the insurance or guarantee method of safeguarding is being used it is incumbent on the firm to ensure that arrangements have been made to renew or replace the policy before any expiry date, and the renewal or replacement should be notified to the FCA.

The proposed guidance on 'unallocated funds' is likely to require firms to open another bank account into which to place these funds in order to be compliant. In the current market environment, this may provide difficult and expensive for firms, particularly as the account in question may never be used.

The proposed guidance, also, says that these are not relevant funds, on the basis that they are not "funds received from, or for the benefit of, a payment services user for the execution of a payment transaction" (Reg 23(1) PSRs or "funds received in exchange for electronic money that has been issued" (Reg 20 (1) EMRs.

In our view, the fact that the funds in question will have been paid into the account used for the collection of relevant funds means that the funds were intended for a payment service or the issue of e-money. Therefore, an inability to identify them is likely to be due to a reconciliation issue. On the principle set out in 10.65 in the Approach Document, that in the case of discrepancy the higher amount should be safeguarded, we would suggest that it would be simpler and provide greater protection for customers if these funds were safeguarded, with guidance that, if the funds are unable to be identified within two working days, they should be returned to the remitter. This would also be consistent with the approach for unidentified client money set out in the Handbook at CASS 7.13.37 & 7.13.38.

On disclosing information on the treatment of funds upon insolvency to customers, we would suggest that a suggested template wording as to how safeguarding should be referenced would be helpful both to firms and to the customers concerned. We would, also, suggest that banks issuing e-money should be required to make clear that such e-money is neither protected by Financial Services Compensation Scheme (FSCS) nor safeguarded. The five bullet points provided in the consultation are helpful, but we would suggest that a greater level of detail on how such a plan should be produced will be needed to enable firms to provide meaningful and useful documents.

2.3. Question 3

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

We are concerned that the draft guidance on intra-group receivables may have wide-ranging impacts on firms and appears to be considerably more onerous than the regime imposed on investment firms by the Capital Requirements Regulation. While it is recognised that this is positioned as 'best practice' we would suggest that it is inequitable to introduce such a major change in treatment without first undertaking a detailed impact analysis.

In addition, given the small size of some payment institutions, we believe that more detailed and simple language guidance on how firms should monitor capital adequacy and carry out stress testing would be helpful in improving industry understanding and compliance. For example, guidance on what constitutes 'intra-group receivables' for this purpose would be welcomed.

2.4. Question 4

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

While it is noted that the requirement for wind-down plans was mentioned in Maha El Dimachki's podcast at the end of 2019, this is a new requirement for this sector and firms are likely to have little experience or understanding of what is involved.

The nature of payment services means that, in general, the wind-down process should be shorter and more straightforward than required for an investment or other firm regulated by the Financial Services and Markets Act (FSMA) 2000. As a result, the guidance in the Wind-Down Planning Guide in the FCA Handbook (WDPG) is likely to prove excessive for most firms affected. As such, again clearer guidance would be welcomed.

3. ABOUT COMPLIANCY SERVICES

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Compliancy Services is one of the UK's leading providers of compliance consultancy and regtech services.

Our award-winning services help firms that are subject to regulation by the Financial Conduct Authority or the Prudential Regulation Authority to become authorised, manage their ongoing compliance and regulatory obligations and empower their staff with focused compliance training.

What makes us stand out is the skill and expertise of our team, which includes ex-regulators, industry practitioners and subject matter experts. Through the breadth and depth of their collective expertise and experience we offer an outstanding service, interpreting the regulations, providing practical, usable advice and solutions that work for your business and the regulator – and ensuring that compliance makes a positive contribution to your business.

Specialist consultant led services helping to minimise the regulatory burden and using technology to reduce the cost of compliance, provide transparency and traceability and deliver management information that enables more informed risk and compliance management decisions.

Our dedicated Payment Services Practice has a dedicated team of consultants specialising in payments and, in particular, supporting clients with applications for authorisation.

It is led by James Borley, formerly Head of the FCA's Authorisations team responsible for payment services, and Accountable Executive for implementation of PSD2 by the FCA. He was also a member of the EBA's Working Group which developed the information requirements set out in their authorisation 'Guidelines'.

Our Technical Director - Payments is John Burns, one of the UK's foremost compliance experts in payment services. He has worked in senior positions for the Association of Payment and Clearing Services, the Payments Council, the Financial Services Authority (now the FCA) and major banks, including Lloyds.

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