Financial Services Consumer Panel
AN INDEPENDENT VOICE FOR CONSUMERS OF FINANCIAL SERVICES

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By email: cp24-20@fca.org.uk

Dear Sir/Madam,

Financial Services Consumer Panel response to FCA CP24/20: Changes to the safeguarding regime for payments and e-money firms

The Financial Services Consumer Panel (the Panel) welcomes the opportunity to respond to the FCA's consultation on the safeguarding regime for payments and e-money firms.

It is crucial that the FCA put the consumer at the centre of the Safeguarding Regime, keeping front of mind two key considerations:

Firstly, payments touch everyone – unlike many other financial services and products – they are not optional, nor are they for the privileged, sophisticated or affluent few. Payments are crucial to each and every UK citizen and have to be accessible to and used and trusted by all types of consumer – whether or not they are financially, legally or digitally literate. The Payments sector needs to serve *everybody* in the United Kingdom, enabling them to pay and be paid – or it serves none of us.

Secondly, public trust in money is key. This trust depends in large part on the public's ability to receive, store and pay out money. ***All*** providers engaged in these activities, regardless of size or shape, must therefore be held to similarly high standards. Strict regulation and supervision must underpin their participation in the payments market if payments are to be safe, serve the consumer and wider economy – and, indeed, if trust is to be retained in money itself.

As we have stated in previous responses, the Panel has reservations about the existence of a 'money' and payments regime which distinguishes between forms of money and payment providers. All money is systemic to those that hold it and all payment providers are systemic to those that depend on them.

While we recognise that the systemic and prudential risk to the UK is orders of magnitude larger in the event of a large credit institution's failure, the existential risk to those consumers who hold their funds at smaller e-money firms who might fail should not be ignored, nor should their needs be underestimated.

Under the status quo consumers are encouraged to think of e-money as alternatives to commercial bank money held in current or deposit accounts. For e-money to be usefully considered as such, it needs to offer at least the same level of surety, protection and immediacy as commercial bank money. Any lighter regime designed for these firms must not compromise on these aspects or they will risk undermining consumer confidence not only in the affected firms, but potentially in the money system more widely.

As stated above, the FCA must put the consumer at the centre of this Review. We have previously encouraged HMT to revisit the Safeguarding regime and, in particular, where and how it is used. We would question whether this complex and risky regime is appropriate for backing what are promoted to the most vulnerable (and likely poorest) of consumers as being the most basic and accessible payment accounts.

In addition, we would point you to related research that the Panel recently published, which looked at consumer understanding and use of non-traditional payment mechanisms. In that report we noted that the risks and protections associated with non-traditional payment methods are complex, and often very different to traditional methods – making it important that firms ensure that consumers genuinely understand the costs, risks and actual protection and redress processes associated with their chosen payment option. We recommended that the FCA should consider asking providers of non-traditional payment mechanisms how they are assuring themselves that their customers understand the information provided in this regard, as required by the consumer understanding outcome of the Consumer Duty, and also that the FCA should consider conducting consumer research to test consumers' actual understanding.

Before concluding, we would like to take this opportunity to set out our view of what a well-functioning payments landscape looks like for UK consumers. As in all areas of financial services, we believe payments firms should have a duty to act in the best interests of consumers. The market, and therefore this review, should also be guided by the following principles:

- **Accessibility -** All UK consumers must be able to pay and be paid. The system must be accessible to all.

- **Fairness and affordability -** The cost of making payments should not exclude particular consumers, businesses of transaction types. It should not cost more for the poorest to pay.
- **Reliability -** Individual payment systems must be robust and reliable with appropriate redundancy measures in place to ensure continuity of service in case of need.
- **Sustainability –** The Payment System should be operated on an economically sustainable basis. The failure of individual payment systems should not result in consumer losses.
- **Safety, security and consumer protection –** Individual payment systems must be safe and secure. The Payment System should offer at least a minimum level of protection to consumers, including against fraud and losses as a result of firm failure.
- **Transparency –** Individual payment systems' costs and protections must be clear and easily understandable. Individual payment systems should offer full transparency about how end users' data is used, by whom and to what end.

Helen Charlton
Chair of the Financial Services Consumer Panel

Annex 1

Question 1: Do you agree with our 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.

We agree with the proposed requirements, however we are unclear about the paragraph under "Notification Requirements" which states:

Notification requirements: Firms will be required to inform us in writing and without delay if: their internal records are materially out of date, inaccurate or invalid; they will be unable to perform an internal or external reconciliation; it will be unable to remedy a discrepancy in its reconciliations; <u>at any time in the previous year there was a material difference between the amount of relevant funds they were safeguarding and the amount they should have been safeguarding</u>. This is in addition to other notification requirements.

This would seem to suggest that the firms only need to report annually – and retrospectively – if there has been a material difference between the amounts they *should have been* safeguarding and the amounts they *did* safeguard. In our view, firms should be required to report <u>immediately</u> when they find any difference between the amount of relevant funds they should be safeguarding and they are safeguarding.

Question 2: To what extent will firms incur operational costs relating to record keeping, reconciliation and resolution packs when moving from the interim to end state?

The costs that firms will incur should not materially affect the FCA's deliberation of these requirements. Indeed, any firms reporting significant cost increases as a result of these rules, should serve as red flags since, by definition, this information should be clear and accessible to them at all times.

Question 3: Do you agree with our proposals for requiring external safeguarding audits to be carried out in both the interim and end state? If not, why not?

Yes we do.

Question 4: Do you agree with our proposals to require that safeguarding audits are submitted to the FCA? If not, why not?

Yes we do.

Question 5: Do you agree that small EMI's should be required to arrange an annual safeguarding audit? If not, why not?

Yes we do.

Question 6: Do you agree with our 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.

The FCA proposes that firms safeguarding returns are submitted monthly. This periodicity would seem to be sufficient *provided* – as stated under (1) above – that firms notify the FCA of any shortfall immediately it is identified.

Question 7: Do you agree with the proposed data items to be included in the report? If not, please explain why.

Yes we do.

Question 8: Do you agree with our proposals to make prescriptive rules on the segregation of relevant funds in both the interim and end state? If not, please explain why.

Yes we do.

Question 9: 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.

We strongly agree with the requirement that funds be received directly into designated safeguarding accounts however we are very concerned by the specified exception under 6.8. We would expect that a large amount of these funds are being received either through a merchant acquiror, through an account held to participate in a payment system or as cash. This is overly large and would appear to be designed to mollify firms' concerns about their operational challenges rather than address the risks consumers face.

**Question 10: 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.**

We agree.

Question 11: 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.

We have some reservations about firms continuing to do this on two key counts. Firstly, the security and liquidity of any asset can change rapidly – even the safest of assets as we witnessed in September 2022. Secondly, such investments will fluctuate causing mismatches between the value of the investments and value of the funds that should be being safeguarded. Given that firms appear to have operational challenges in simply managing the flows of customer payments in and out of their accounts, we would question whether the additional layer of complexity involved is one that they can actually manage.

Finally, the FCA argues that the rationale for preserving this capability is because some Payments Firms continue to experience difficulties accessing safeguarding accounts with Credit Institutions. It says that these difficulties stem in part from the risk appetite of credit institutions. We would suggest that this evidences how urgent it is that Payment Firms take steps to address the risks Credit Institutions are concerned about and would encourage the FCA to make firms address these risks with urgency.

Finally, we would caution that some firms may have business models which rely heavily on returns from these assets and will chase yield at the expense of safety. As we understand it, the Bank of England is considering limiting backing assets for Regulated Stablecoins to short term same-currency government debt. We see no reason why, if there is to be an investable asset regime for e-Money, it should differ to that proposed for Regulated Stablecoins

Question 12: 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.

No, please see above.

Question 13: 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.

We believe that the assets should always be held by a custodian. Given firms' records of being unable to reconcile and the huge amount of shortfalls in funds owed vs safeguarded, we do not consider it appropriate that they be able to act as custodians. A third party custodian will also provide (some) additional assurance where it comes to asset valuation.

Question 14: 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.

AND

Question 15: 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.

We have significant reservations on the use of insurance policies and comparable guarantees. These have the potential to hugely complicate the costs and risks to consumers, as well as delaying payouts in the case of insolvency. While we recognise the FCA is trying to improve on the provisions in their proposals we do not think that it is appropriate for e-Money firms to rely on risky investment income for their solvency and profitability, leaving consumers subject to a risky insurance process. The smallest discrepancy between the firm's processes and the insurance policy will put consumers at significant risk – not just to lower or delayed payouts, but potentially to no pay-outs.

Question 16: 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.

We do not think that the safeguarding regime is suitable for Payments and needs to be replaced with urgency. A statutory trust is an improvement on the status quo, however we are not qualified to judge as to whether it is the best. We would advocate for a solution that gives consumers equal protections to those that they enjoy at credit institutions.

Question 17: 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.

We do not agree with the proposal that a single asset pool be allowed to mix e-Money and unrelated Payment Services funds. E-Money deposits should be segregated from other funds and not be put at risk to shortfalls from other business activities.

Question 18: Do you agree with our proposals to clarify when the safeguarding requirement starts and ends? If not, please explain why.

We do agree with these proposals, however, they should only apply where the acquiror is not the e-money firm. Where the acquiror **is** the e-money firm then the safeguarding requirement should start and end at the point of payment.

Question 19: 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.

We do. If anything we believe the dates should be brought forward.

Question 20: Do you agree that the transitional provisions are appropriate? If not, please explain why.

Yes so long as scrutiny on these firms is increased in the interim.

Question 21: Do you consider that any other transitional provisions are needed? If so, please explain why.

We believe that increased supervision of the sector is an imperative given the discrepancy in FSCS protection. The potential for consumer harm, the growth in e-money deposits, the huge sums now held in e-money and the large number of vulnerable customers using e-money make this particularly urgent.

Question 22, 23 and 24 Do you agree with our assumptions and findings as set out in this CBA on the relative costs and benefits of the proposals contained in this consultation paper? Please give your reasons.

Question 23: Do you have any views on the cost benefit analysis, including our analysis of costs and benefits to consumers, firms and the market?

Question 24: Do you have any views on whether our proposals will materially impact any of the groups with protected characteristics under the Equality Act 2010? If so, please say how?

The regime is being delivered in two stages: an "interim" stage that is primarily focussed on ensuring compliance with the current safeguarding regime; followed by an "end-state" that will replace that safeguarding regime when it is repealed. As such the FCA's cost benefit analysis should be limited to the second part of the regime – the costs that firms may or may not face complying with what they should already have been complying with is not material and should not come into the FCA's considerations.

Overall, we believe the costs are more than justified by the much needed improvements in consumer protection.