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E-money and online payment institutions: when it all goes wrong

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The 2007-2008 financial crisis and the devastating reminder that banks were not immune from failure, brought about a raft of regulatory changes designed to protect customers and the wider economy. These included, if all else failed, bespoke administration procedures for banks, building societies and investment banks contained within the *Banking Act 2009* ("BA 2009").

Since then the European Union Payment Services Directives have created new players to compete with banks in providing payment services with the intention of increasing competition, reducing costs and promoting innovation: electronic money institutions ("EMIs") and payment institutions ("PIs"). In the UK, such institutions are regulated by the FCA pursuant to *The Electronic Money Regulations 2011* ("EMR 2011") and *The Payment Services Regulations 2017* ("PSR 2017").

Unlike banks, these new players are not authorised to accept customer deposits, but they are allowed to provide services such as credit transfers, direct debits, electronic credit card transactions and money transfers. An EMI can also provide a digital account (often referred to as an "e-wallet"), although this is not to be confused with cryptocurrency. There are now over 1,300 such firms in the UK and this growth has increased the number of customers exposed to risk if these firms fail. However, customer funds are not protected under the Financial Services Compensation Scheme and no special insolvency regime applied to such institutions.

Following a consultation, the Government concluded that the existing insolvency regime is suboptimal for PI and EMI customers, noting that in recent administration cases customers have been left without access to their money for prolonged periods of time and have received reduced funds (if any) as a result of high distribution costs. The insolvencies of Premier FX Limited and Ipagoo LLP are two are two examples of this. The result is the coming into force on 8 July 2021 of *The Payment and Electronic Money Institution Insolvency Regulations 2021* ("Regulations").

"Whilst the failure of an EMI or a PI will inevitably have serious consequences for customers, it is to be hoped that the new regime will make management of the process quicker, clearer and ultimately lead to customers receiving their funds more quickly."

The main purpose of the Regulations is to create a special administration procedure for PIs and EMIs, although this does not preclude "ordinary" administration under *Schedule B1* ("Sch. B1"), subject to the additional conditions in Reg. 11 being satisfied.[1] Key features of the new procedure are that:

- An administrator can be appointed only by court order on application by specified persons (including the institution, creditors of the institution, the FCA and the Secretary of State) on notice to the FCA if it is not the applicant (Reg. 8)

- For applicants other than the Secretary of State the grounds to be met are that the institution is, or is likely to become, unable to pay its debts[2] (Ground A) **or** that it is fair to put the institution into special administration (Ground B). The Secretary of State may apply if Ground B is met **and** that it is expedient in the public interest to so do (Ground C) (Reg. 9)

- At the application hearing, the court has similar powers to those under para. 13(1), Sch. B1 when hearing a Sch. B1 administration application. The court may treat an application by the FCA as one for Sch. B1 administration under s.359(1) of the FSMA 2000 (Reg. 10)

- The administrator has three specified objectives, but there is no specified hierarchy and it is for the administrator to prioritise work as he or she thinks fit to achieve the best result overall for users, holders and creditors. Objective 1 is to ensure the return of "relevant funds"[3] as soon as reasonably practicable in accordance with the detailed provisions in Regs. 13 to 15 and 17 to 34 or, promptly, in the case of post-administration receipts in accordance with Reg. 16. Objective 2 is to ensure timely engagement with stakeholders including the Bank of England, the Treasury and the FCA. Objective 3 is to either rescue the institution as a going concern or wind it up in the best interests of creditors (Reg. 12)

- In other respects the procedure is the same as for administration under Sch. B1, subject to modifications and the inclusion of certain liquidation provisions of the *IA 1986* (Reg. 37)

A summary of the draft insolvency rules to accompany the new procedure (the PI and EMI SAR Rules) was published in December 2020. The proposed rules are modelled on the Rules of the Investment Bank Special Administration Regime. Implementation of the PI and EMI SAR Rules will be required before the special administration procedure can be used.

Whilst the failure of an EMI or a PI will inevitably have serious consequences for customers, it is to be hoped that the new regime will make management of the process quicker, clearer and ultimately lead to customers receiving their funds more quickly. This in turn should drive confidence in the sector and lead to further growth, innovation and competition with traditional financial institutions.

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[1] The Regulations also insert, with modifications, Part 24 of *FSMA 2000* into the *PSR 2017* thereby importing the provisions which give the FCA and the PRA powers to participate in insolvency regimes.
[2] A bank that is in default on an obligation to pay a sum due and payable under an "agreement" (defined as one where the making or performance of which constitutes or is part of the regulated activity on the bank), is to be treated as unable to pay its debts, and s.123, *IA 1986* also applies: Reg 9(2) and s.93(4), *BA 2009*.
[3] As to which see Reg. 23, *PSR 2011*.

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