

9 July 2020

Dear CEO

**Portfolio strategy letter for payment services firms and e-money issuers****We expect you to act to prevent harm to your customers**

In our [2020/21 Business Plan](#), we announced that the risks to consumers in the payment services sector are an FCA priority requiring supervisory focus and intervention. Payment services firms include payments institutions (PIs) and e-money institutions (EMIs). In this letter, we set out the actions we expect you to take to prevent harm to your customers by ensuring you are compliant with your regulatory obligations across six key areas.

In light of the issues presented by the coronavirus (Covid-19) pandemic, addressing any weaknesses in these key areas is an important priority. We have therefore also published our [feedback statement](#) and [finalised guidance](#) following a short [consultation](#). The guidance provides additional direction for firms to meet their safeguarding requirements and it outlines the FCA's expectation of firms to put in place more robust plans for winding down, so that customer funds can be returned in a timely manner.

We expect you to consider and discuss these key areas and additional guidance with your fellow Directors and/or Board and agree what further action you should take to ensure that your firm meets the requirements. When doing so you should also consider the guidance set out in our [approach document](#). Principal firms should ensure their appointed agents comply with the contents of the letter that are relevant to them.

If we contact your firm in the future, we will expect you to explain the actions you and your Board have taken in response to this letter to ensure that your customers are adequately protected.

**Why payment services firms and e-money issuers are a priority**

The payments and e-money sectors continue to develop quickly. An increasing number of firms and new products are entering the market. More consumers and businesses are using PIs and EMIs.

We are concerned that consumers may not understand the lack of protections they have when using some of these products and services. This is why, in February 2020, we published [communications](#) to help consumers understand how different protections apply to products and services in the sector.

Some firms are growing rapidly and many are unprofitable, while they seek to grow market share. We are concerned that the pandemic will affect payment services firms' financial strength and may impact the availability of external funding. This means that firms that need to regularly raise fresh capital to remain solvent may fail.

We welcome the innovation and competition we are seeing in payment services. But, as with all growing markets, we are also monitoring it closely for any harms to consumers or market integrity it may cause. It is vital for the consumers who use these services and for continued public confidence in them, that all firms recognise and manage key risks appropriately.

### **You have obligations as an FCA-regulated firm**

An FCA-regulated firm must comply with the rules that apply to it. For payment and e-money institutions, these include the [Payment Services Regulations 2017](#) (the PSRs) and the [Electronic Money Regulations 2011](#) (the EMRs). Firms must continue to meet the conditions of authorisation at all times. These are the conditions on which firms are granted permission to provide payment services and issue e-money. If we identify firms not meeting these conditions, or otherwise failing to comply with the PSRs or EMRs, we will take action to ensure customers are protected.

In addition to the PSRs and EMRs, the FCA's Principles for Businesses (PRIN) were extended to apply to PIs and EMIs from 1 August 2019. The Principles are a general statement of the fundamental obligations of firms. Breaching a Principle makes a firm or other person to whom the Principles apply liable to disciplinary sanctions. So, you should consider how the Principles apply to your firm and make any necessary changes to comply with them.

### **We have identified six key areas where non-compliance with these obligations harms consumers**

We have found that issues in these areas are widespread and many firms may be failing to meet the required standards. You are responsible for ensuring that the appropriate people at your firm understand the rules and ensure that your firm complies with them. If in any material respect you are not meeting the rules and standards you must notify the FCA immediately setting out what you are doing to remedy any breaches.

**1. Safeguarding** – Authorised Payment Institutions (APIs) and EMIs must have appropriate and well-managed safeguarding arrangements so that, if a firm becomes insolvent, customers' funds are returned in a timely and orderly way. Firms must be able to show that relevant funds are appropriately identified and managed on a day-to-day basis.

Following our [review of firms' safeguarding practices](#), which found widespread issues with the way firms safeguard customer funds, we sent a [Dear CEO letter](#) to all EMIs and

APIs requiring them to review their safeguarding arrangements and attest that they were satisfied they met the requirements. We are now doing further work to test firms' safeguarding arrangements. While we have seen some improvements, we are still finding material issues including:

- firms either not holding appropriate safeguarding accounts, being unable to evidence appropriate account designation or being unable to demonstrate through an acknowledgement or otherwise, that the authorised credit institution or authorised custodian has no rights (e.g. a right of set off) or interest (e.g. a charge) over funds or assets in that account unless permitted by reg 23 PSRs/reg 21/24 EMRs.
- inadequate frequency of reconciliations to remove own funds and address safeguarding discrepancies
- a lack of clear records to evidence the relevant funds held and that appropriate reconciliations have been undertaken to check this amount

#### Action to take

Firms should review their safeguarding arrangements regularly to ensure these remain complaint at all times and in particular as your business changes. Following a short consultation, we have set out some additional safeguarding guidance. We expect to see that firms have acted to review and remediate their safeguarding arrangements where required taking into account the guidance in our approach document and the guidance published today. We will continue to proactively test firms safeguarding arrangements. Where we find inadequacies, we will take action to prevent customer harm.

**2. Prudential risk management** – Firms must ensure they have adequate financial resources. This means meeting own funds requirements at all times, having sufficient regulatory capital to be able to incur losses while remaining solvent, or to fail in an orderly way. It also means having a sufficient quantity and quality of liquid assets to be able to pay debts and meet obligations as they fall due.

During our recent supervisory engagement with the sector, we found several firms had calculated their own funds requirement incorrectly and others with inadequate governance and controls to manage prudential risk appropriately.

#### Action to take

Maintaining robust prudential risk management is essential at all times. This has been brought sharply into focus by the impact of coronavirus because firms may not be able to readily raise external funding. Following a short consultation, we have set out some additional guidance to strengthen firms prudential risk management. We expect to see that firms have acted to review and remediate these processes where required. We will continue to test firms' financial position and will take appropriate action where firms do not meet the requirements.

**3. Financial crime** – Combatting and preventing financial crime is a key cross-sector priority for the FCA. All firms should be alert to the risk they could be used to facilitate fraud, money laundering, terrorist financing, bribery, corruption and other financial crime. Your firm should operate appropriate systems and controls to mitigate these risks and comply with financial crime reporting obligations. During recent supervisory engagement with the sector, which included firm visits, assessments and a review of

100 firms' anti-money laundering processes, we found several firms were failing to take appropriate steps to properly manage their financial crime risks. Among the issues we identified were:

- firms not having an effective business-wide anti-money laundering risk assessment
- the absence of customer risk assessments or assessments with methodologies that didn't include all relevant risk factors
- a lack of effective and risk-sensitive enhanced due diligence for high-risk customers and
- senior management and firms not having adequate oversight of agents, particularly where these operate overseas

#### Action to take

Firms must be aware of the financial crime risks inherent within their business and ensure they operate a robust framework with appropriate governance to make sure that standards are met. Firms must also consider the financial crime risks posed by innovative products, unusual or agency-type business models and cross-border payments. As part of our proactive supervisory strategy, we will continue to undertake targeted assessments and will take action against firms that fall short of our expectations.

**4. Financial promotions and consumer communications** – Consumers rely on the information provided in firms' advertisements and websites to make decisions on whether to use a firms' products. We recently reviewed the financial promotions of a sample of firms for compliance with the rules and guidance in PRIN and chapter 2 of the Banking Conduct of Business sourcebook (BCoBS), which came into effect 1 August 2019. We identified several issues, including:

- claims about service and pricing that cannot be substantiated
- use of FCA regulatory status in a promotional way, including inappropriate use of terms such as 'secure'
- inappropriate use of the term 'free' when describing costs and charges relating to a currency conversion
- promotions for electronic money providing a misleading impression the firm is a bank

#### Action to take

Firms should review their financial promotions to ensure they are clear, fair and not misleading. Firms should be putting their customers' interests at the heart of their business, and this includes when they draft, publish and review financial promotions. It is especially important that firms consider the potential harm for consumers should they buy or be sold the wrong products or services due to misleading, unfair or unclear promotions. We will continue to undertake proactive reviews of financial promotions and will contact firms to address any issues that we observe.

**5. Governance and oversight** – Based on our observations, a root cause of many APIs' and EMIs' regulatory issues is inadequate governance and oversight. In particular, we have observed that many firms do not review their regulated processes sufficiently frequently to ensure that they remain compliant as the business changes or grows. As

a condition of authorisation, the directors and management of APIs and EMIs must possess appropriate knowledge and experience to provide payment services and for EMIs, issue e-money.

It is your responsibility to ensure that your institution maintains robust governance arrangements for regulated business, including activities undertaken on your behalf by agents and distributors. This includes having well-defined, effective risk-management procedures and internal control mechanisms which are comprehensive and proportionate to the nature, scale and complexity of the regulated services your firm provides (e.g. there should be appropriate systems and controls in place to prevent and mitigate harm arising from IT resilience and cyber risks, which includes an understanding of the wider impact disruption might have). Firms should also consider the risks arising from reliance on intra group operations and have appropriate contingency plans in place to mitigate these risks. A UK-authorized PI or EMI must have its head office in the UK. The directors and other senior management, who make decisions relating to the firm's central direction, and the material management decisions of the firm on a day-to-day basis should be based in the UK head office.

#### Action to take

Firms' senior management must ensure that processes are reviewed regularly and governance functions are appropriately scaled to reflect the growth of that firm and the risks that apply to it.

**6. Records management and reporting** – PIs and EMIs must maintain records relating to their compliance with the PSRs and EMRs. Your firm may also be required to provide certain data and information to us through regulatory returns and ad hoc requests. Our work has highlighted material inaccuracies and omissions in the information that firms provide to us through regulatory reporting and responses to requests for information. We have also found that in most cases, record keeping of regulated processes is inadequate to demonstrate they have been conducted in a manner which meets the requirements.

#### Action to take

Firms must ensure the records they maintain are sufficient to demonstrate their compliance with the regulations. And they must make sure they give us accurate and clear information on time.

### **We will act swiftly and decisively if you fail to meet our expectations**

We base our action on intelligence and proactive analysis using a range of indicators to identify firms to proactively contact, or visit to ensure that the relevant standards are met. Where we identify weaknesses, we will take action to ensure that firms meet the requirements. If we see a firm's actions are likely to lead to consumer harm we will act swiftly. This may include restricting permissions to conduct regulated activity and cancelling permissions if it will protect consumers.

### **Preparing for Brexit**

The UK left the EU with a Withdrawal Agreement on 31 January 2020 and entered a transition period, during which it will negotiate its future relationship with the EU. The

transition period is due to operate until 31 December 2020. During this time, EU law will continue to apply in the UK and passporting will continue. As matters develop during this year, you will need to consider how the end of the transition period will affect you and your customers, and what action you may need to take to be ready for 1 January 2021.

#### Action to take

If you have customers in the EEA, you will need to decide on your approach to servicing your existing contracts with them. You should be guided by what is the right outcome for your customers and take the necessary steps to follow local law and regulator expectations. In many cases, it would be a poor outcome for your customer if you suddenly stopped servicing them.

For information on Brexit, including what the transition period means, visit our [website](#).

#### **Next steps we expect from you**

We expect you to consider and discuss this letter with your fellow directors and/or Board and agree what further action you should take to ensure that your firm meets the requirements. We also expect Principal firms to ensure their appointed agents comply with the contents of the letter that are relevant to them.

If you have any questions please contact your normal supervisory contact or the FCA Supervision Hub on 0300 500 0597. We know there may be occasions when your firm faces urgent issues. In such significant circumstances, please ask to speak directly to payments supervision.

Yours faithfully

David Geale  
Director of Retail Banking and Payments Supervision