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New Obligations for U.K. Payment Institutions and E-Money Issuers

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In a drive to improve standards in the payments and e-money industries, on 1 August the Financial Conduct Authority ("FCA") published a consultation on *General Standards and Communication Rules for the Payment Services and E-Money Sectors* (CP18/21). The proposals, if implemented, will have important implications for firms which are authorised under the E-Money Regulations and Payment Service Regulations as opposed to under the Financial Services and Markets Act 2000 ("FSMA"). The FCA's consultation also has implications for FSMA authorised firms as regulations are being extended to cover payments-related activities when carried on by such firms.

A link to the FCA's Consultation can be found here.

An Uneven Playing Field – The Problem Being Addressed

The FCA believes that there is an uneven playing field between FSMA authorised firms and firms which are authorised or registered under the Payment Services Regulations 2017 ("PSRs") or Electronic Money Regulations 2011 ("EMRs"). Firms providing the same or similar services are presently held to different standards by the regulator, owing to the different rules that apply to them.

The FCA recognises that the PSRs and EMRs are intended to provide *a lighter touch regulatory regime* but the current framework results in an inconsistent approach and therefore potentially inconsistent outcomes for consumers. It also limits the FCA's ability to address conduct that does not adhere to the standards required by the FCA of other industry participants. Of course, these regulatory changes are proposed against the backdrop of convergence between different business models. Many firms opt to become E-Money Issuers ("EMIs") as opposed to fully fledged banks because of lower barriers to entry. An e-money licence allows a firm to provide most of the functionality of a bank to its customers, with the caveat that the firm cannot pay interest on the account. Given the growth of the e-money and payments markets and perceived conduct failings, the FCA is keen to use new powers to extend FSMA based obligations across the board.

The Principles for Businesses

The FCA's Principles for Businesses are fundamental high level standards that apply to FSMA regulated firms. The Principles impose obligations on firms to act with integrity and to treat customers fairly, amongst other matters.

The Principles do not apply to authorized Payment Institutions ("PIs") nor to EMIs. Additionally, the Principles do not apply to FSMA regulated firms when they are providing payment services.

To bring about a level playing field, the FCA is proposing to apply the Principles to:

- the provision of payment services and connected activities;
- the issuance of e-money where this is not an FCA regulated activity (i.e., where the activities are not engaged in by FSMA firms) and connected activities; and
- Payment Institutions and E-Money Issuers.

While the FCA does have power to take action against PIs and EMIs for unfair commercial practices under the Consumer Protection from Unfair Trading Regulations, these powers are limited in comparison to the FCA's powers to take action in respect of breaches of its Principles. The Principles are broadly drafted and set high standards for firms to comply with. This can be contrasted with the PSRs and EMRs, which set out detailed rules that provide relative certainty to firms as to the scope of their obligations. The Principles can introduce uncertainty and subjectivity as to the nature of obligations that apply to firms given that they are based around broader concepts such as fairness and reasonableness.

Extending the Principles to APIs and EMIs will therefore increase the obligations of such firms and expose them to a greater risk of regulatory enforcement. For example:

- Principle 1 *Integrity* – although the PSRs and EMRs apply fit and proper criteria for those involved in running firms, there is no current equivalent to the Principle 1 Integrity requirement. It is important to note that Integrity is not exclusively an issue of probity in that various FCA enforcement cases have found a lack of integrity to be triggered where there is recklessness on the part of the firm. Unintentional conduct is therefore enough to result in a firm being found to lack integrity.
- Principle 3 *Management and Control* – this Principle is often relied on in enforcement cases where the FCA has been concerned with the manner in which the firm has been managed. The Consultation states that this articulates requirements around the reasonable care that firms must take. Again, there is presently no such broad requirement on PIs and EMIs.
- Principle 6 *Customers' Interests* – Principle 6 sets out the obligation to treat customers fairly. It will introduce broader obligations and it will not be sufficient for firms to point to compliance with specific rules in the PSRs and EMRs if questioned by the FCA on customer outcomes. The Consultation states that "*while meeting the requirements of the PSRs and/or EMRs is essential, customers must be treated fairly in general*". Compliance with the rules will, therefore, just be the starting point.

One point to note is that many of the Principles refer to obligations which relate to "*customers*". The FCA states that in the context of PIs and EMIs they will define "customers" as consumers (including micro-enterprises and charities with an annual income of less than £1 million). The FCA has specifically decided not to apply the Principles to relationships with all "users" of payment services or "holders" of e-money, which would bring relationships with business customers within scope. The FCA is keen to maintain the distinction between corporate and non-corporate customers.

Regulating Communications with Clients

In their consultation, the FCA has expressed concern as to the communication practices of certain PIs and EMIs.

Communications made by FSMA firms can be regulated as financial promotions. They are also subject to the FCA's Principles including the Principle 7 (*Communications with Clients*) which provides that a *firm must pay due regard to the information needs of its clients and communicate information to them in a way which is clear, fair, and not misleading*. Presently, for PIs and EMIs the FCA has not made any rules in relation to the form and content of communications. There are also no rules in the PSRs or the EMRs that relate to marketing practices, such as prohibiting those that could be unfair or misleading.

In its consultation, the FCA proposes extending conduct of business rules on communications with customers to PIs and EMIs.

At the moment, rules on communications with clients are set out in the FCA's Banking Conduct of Business Sourcebook ("BCOBS"), which applies to banks. The FCA is proposing extending the application of Chapter 2 of BCOBS to PIs and EMIs to impose specific obligations on them in relation to communications with customers.

The BCOBS sets out a high level requirement for communications to be clear, fair, and not misleading.

Under the FCA's proposals a new category of promotion will be introduced, *a payment service or electronic money promotion*, which is defined as an invitation or inducement to enter into an agreement for the provision of a payment service, initiate a payment order, or acquire electronic money.

The extension of BCOBS to cover e-money issuers and payment service providers will only apply to communications made to "*customers*" in the sense described above.

For communications that are within scope, firms will need to include the name of the provider of the service on the communication and ensure that it is accurate, does not emphasise benefits without also giving a fair and prominent indication of any relevant risks, and does not disguise or diminish important information or warnings.

Misleading Communication of Currency Exchange Transfer Services

A particular concern of the FCA is communication relating to *currency exchange transfer services*. These are, broadly, remittance or transfer services that involve a currency conversion.

The FCA states that research has identified various concerns and failings in communications made in this market. They also point to ASA upheld complaints in relation to instances of misleading advertising in this market. Of particular concern to the FCA is the promotion of unachievable exchange rates to consumers and unfair or unbalanced comparison claims made in relation to the cost of a service provided by another provider.

The FCA proposes amending the BCOBS to provide that a promotion relating to a currency exchange transfer service is likely to be misleading if it presents an exchange rate in a way that is likely to give the impression that the rate is available to a person or class of persons, if that rate is unlikely to be obtained by that person or class of persons with respect to a typical transaction.

Moreover, the FCA proposes that where a provider compares the costs of their service with other providers, they do so in ways that are meaningful, fair and balanced, and capable of being substantiated.

Increased Enforcement Risk

If implemented, it seems clear that the changes in the FCA's rules will allow the FCA to take more enforcement action against PIs and EMIs.

The draft amended rules are clear that breaching the Principles will render the firm liable to disciplinary sanctions.

The FCA notes that they "*want our suite of disciplinary powers to be available to us*" and that they "*believe that this will make it easier for us to take action to deter misleading practices and ensure communications are presented in a clear and transparent way*".

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If you have any questions concerning these developing issues, please do not hesitate to contact the following Paul Hastings London lawyer:

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