Title: The Payment and Electronic Money Institution Insolvency Regulations 2021	De minimis assessment
SI No: 2021/716	**Date: 31/03/2021**
Other departments or agencies: Click here to enter text.	**Type of regulation: Domestic**
Contact for enquiries: Dora Willcock	**Date measure comes into force: 08/07/2021**
Cost of Preferred (or more likely) Option **Under £5m**	**Net cost to business per year** (EANDCB in 2019 prices) **£0**

1. What is the problem under consideration? Why is government intervention necessary?

The payment and e-money sectors have expanded rapidly over the last decade, with payment and e-money institutions (PIs/EMIs) alone now holding more than £17bn of assets belonging to UK consumers. However, there is evidence that the existing insolvency process for PIs/EMIs is suboptimal for consumers. Recent administration cases involving these types of firms have taken years to resolve with consumers left without access to their money for a prolonged period and receiving reduced monies after the cost of distribution. In order to improve the insolvency process for consumers of PI/EMIs, government intervention through legislation is necessary. Given that the insolvency process for PIs/EMIs is set out in legislation, changes to the insolvency process for these sectors must be made through additional legislation.

2. What are the policy objectives and the intended effects?

This legislation will extend the Financial Services and Markets Act 2000 (FSMA) Part 24 provisions to all PIs/EMIs entering the standard insolvency process. This provides the Financial Conduct Authority (FCA) with specific powers to participate and protect consumers in an insolvency process for PIs/EMIs as it does for other FCA supervised firms.

This legislation will also create a Special Administration Regime for PIs/EMIs (pSAR). The pSAR will give insolvency practitioners (IPs) administering insolvent PIs/EMIs an expanded tool-kit to keep the firm operational while prioritising the return of client assets. This will lead to fewer disruptive insolvencies and reduce the cost of distribution. The pSAR utilises the Investment Bank Special Administration Regime (IBSAR) as a model for this new regime. The IBSAR is a well-established and well-received regime for investment firms and has been in place since 2011. It has had a significant impact on the outcomes for clients and the market in insolvencies, with recent cases demonstrating a return of client assets within the first year of the firm’s insolvency.

Appropriate amendments have been made when drafting the pSAR to reflect the operational and regulatory differences between investment banks and PIs/EMIs. For example, the Electronic Money Regulations 2011 (EMRs) and Payment Services Regulations 2017 (PSRs) provide the safeguarding regime for PIs and EMIs but, unlike the detailed provisions contained in the Client Assets Sourcebook (CASS) for investment banks, these regulations contain only high level provisions on the treatment of customer funds in the event of an institution becoming insolvent. Given this, certain distribution principles have been codified in the pSAR.

3. What policy options have been considered, including any alternatives to regulation? Please justify preferred option

Other policy options including not taking any action were considered. However, not taking action would mean that in a future insolvency of a PI/EMI consumers would be subject to the current insolvency processes which are suboptimal. Considering the significant growth in the sector over recent years, it is necessary to take action now to introduce a new insolvency regime and extend FSMA Part 24 provisions to PIs/EMIs to mitigate potential consumer harms in the event of a future insolvency.

4. Please justify why the net impacts (i.e. net costs or benefits) to business will be less than £5 million a year.

<u>Costs</u>

It is estimated that there will be zero annual direct costs to business, with some one-off and ad hoc direct costs. Ad hoc direct costs are defined as costs that are neither annual nor one-off and may occur when necessary or needed. There are no significant ongoing or one-off direct costs associated with the Regulations. The reasoning for this estimation is as follows:

<u>Direct costs</u>

PIs/EMIs and creditors

- Costs to PIs/EMIs or creditors may arise if they chose to apply for a special administration order to be placed into special administration. Although similar costs already exist in some cases for the current insolvency process, we estimate that this cost would range from approximately £20,000 to £30,000 per institution being placed into special administration. However, this cost would vary on a case by case basis depending on the size and complexity of the institution. The cost of applying for a special administration order would not necessarily be a cost paid by the institution or its creditors. The parties that can apply for a special administration order include: the institution; the directors of the institution; one or more creditors of the institution; the designated officer for a magistrates' court; the Secretary of State; and the FCA.
- There may be one-off costs to PIs/EMIs as this legislation amends the definition of "insolvency event" in the EMRs and PSRs. As a result, some PIs/EMIs may need to amend this definition in their contracts with third parties. However, the exact number of firms cannot be quantified because it depends on whether contracts use text taken directly from the existing EMRs/PSRs or whether contracts refer to definitions within the EMRs/PSRs. This change is most likely to be relevant for the small number of institutions that safeguard using the insurance or guarantee method because they are likely to have contractual arrangements stating that the institution's insurance policy or guarantee will be paid out under a certain definition of "insolvency event". We are aware that of the small number of institutions that safeguard using these methods, many will not be affected by this change. However, where institutions are affected by this change, we estimate that amending contracts to reflect a definition amendment is likely to be of minimal cost.
- A one-off direct cost to PIs/EMIs may arise from the continuity of supply provisions as some institutions may need to change their contractual arrangements with suppliers to comply with them. The number of firms that will need to make these changes cannot be quantified because the need to make this change depends on the contractual arrangements between PIs/EMIs and their suppliers. However, we estimate that amending contracts to comply with the continuity of supply provisions is likely to be of minimal cost.

Consumers

- Costs may arise for consumers or third parties as the bar date and hard bar date provisions require them to pay to submit claims for relevant funds. However, this is usually undertaken in complex insolvencies already, so the additional costs are

considered to be negligible. There is the possibility that if a consumer does not submit a relevant funds claim before the bar date, they may find that they only have an unsecured claim against the general estate for the value of their relevant funds rather than a relevant funds claim against the asset pool. The potential cost of a late claimant having an unsecured claim against the estate rather than a relevant funds claim is unquantifiable because it depends on the size of the shortfall and whether or not the consumer's unsecured claim is eventually paid in full. However, to reduce the possibility of there being a late claimant, there are safeguards being included for the bar date and hard bar date provisions.

- The pSAR provides that any shortfall in the asset pool be borne pro rata by all consumers that hold relevant funds within the asset pool, which could lead to consumers bearing shortfalls which should be borne by other consumers. The cost of this proposal is not quantifiable, as it depends on the circumstances of the administration, for example, how large the shortfall is.

IPs and transferees

- Ad hoc direct costs to IPs may arise as the pSAR provides the FCA with certain powers to direct the administrator. These costs cannot be quantified, and it is expected that the cost would be outweighed by the positive impact of a more managed wind-up of the institution following the FCA's intervention. However, an upper bound estimate for this cost, assuming an additional 35 hours of work for 4 IP compliance personnel at £48 per hour, is a potential cost of £6,720 per insolvency for additional interaction with the FCA.
- Ad hoc costs to the IP and transferee may arise from the pSAR transfer provisions requiring certain contractual undertakings from the transferee. These are expected to be small additional administrative costs.
- Ad hoc direct costs to IPs may arise from the application of FSMA Part 24 provisions to PIs/EMIs. The requirements of these provisions could create additional work for IPs. For example, an administrator is required to obtain consent from the appropriate regulator if they are appointed by the company or its directors. Similarly, there are certain requirements on the IP to report to the appropriate regulator if they consider a company is carrying (or has carried) on a regulated activity that it was not permitted to do. These costs cannot be quantified because they depend on the circumstances of the insolvency. However, an estimate for this cost, assuming an additional 35 hours of work for 4 IP compliance personnel at £48 per hour, is a potential cost of £6,720 per insolvency for additional interaction with the appropriate regulator.

Indirect costs

PIs/EMIs and creditors

- A consultation respondent raised that there may be indirect costs from the continuity of supply provisions through suppliers raising their prices. However, we have seen no evidence for this and believe that any costs will be negligible because the supplier can stop providing a supply if:
  a) any charges in respect of the supply that are incurred after commencement of special administration remain unpaid for more than 28 days;
  b) the administrator consents to the termination of the service; or
  c) the supplier has the permission of the Court, which may be given if the supplier can show that the continued provision of the supply would cause the supplier to suffer hardship.
- It is possible that unsecured creditors might indirectly be affected by the objectives to ensure the return of relevant funds as soon as is reasonably practicable (Objective 1) and to ensure timely engagement with payment system operators, the Payment Systems Regulator and the Authorities (Objective 2). This is, however, considered to be unlikely

because the pSAR is intended to speed up the agreement of unsecured claims and expedite the distribution process for unsecured creditors.

- Creditors may indirectly be affected by the pSAR provisions that relate to safeguarding failures by PIs/EMIs. Costs that are incurred because of a failure by the institution to safeguard relevant funds are to be paid out of the institution's assets, which in turn may worsen the position of creditors. However, this cost is unquantifiable because it depends on the circumstances of the administration, for example, the amount of costs incurred by the institution failing to safeguard relevant funds.

IPs

There is a one-off direct cost to IPs of familiarising themselves with the Regulations. The introduction of the pSAR will provide IPs with new tools to use when administrating the insolvency of PIs/EMIs. If an IP were to take on a PI/EMI insolvency then, based on FCA guidelines, the familiarisation costs would be approximately £24,576 per IP needing to familiarise themselves with this legislation (4 compliance staff to read 200 pages of legal text [16 days each] at a rate of £48 per hour).

- Although there are approximately 1,200 authorised PIs/EMIs, the number of insolvencies varies significantly based on market conditions and firm specific issues. If each insolvency resulted in a different IP being appointed, then it would be possible for multiple IPs to be affected. However, there are only a limited number of IPs capable of resolving complex financial services firms such as these. Even in a year with a significant number of insolvencies, the number of IPs needing to familiarise themselves with these regulations is likely to be fewer than 10.

Transferees, agents and distributors

- Indirect costs to the transferee may arise from the contractual requirements in the transfer provisions, including that the transferee will notify within 14 days agents, distributors and users and holders whose relevant funds have been transferred. This cost is unquantifiable because it depends on the circumstances of the administration, for example the number of users and holders whose relevant funds have been transferred, but it is expected to be a minimal administrative cost. Additionally, the transfer provisions provide that under certain circumstances in a partial property transfer agreement, the transferee must undertake to make good any shortfall in the amount of relevant funds to be transferred that the institution is required to safeguard. This cost is unquantifiable because it depends on the circumstances of the administration.
- Agents/distributors may be indirectly affected by the provisions in the pSAR that, under certain circumstances in a transfer, allow the requirement to obtain consent from agents/distributors to be overridden and the contracts novated. If they are not content with the transfer, agents/distributors have the right to cancel the contract. However, this may mean that the agent/distributor incurs an exit charge or fees, depending on the terms and conditions of the contract. This indirect cost is unquantifiable because it depends on the circumstances of the administration.

<u>Benefits</u>

It is not possible to quantify the monetised benefits of the Regulations as these will depend on the specific circumstances of the administration, but improved insolvency arrangements for PIs/EMIs will lead to the following general benefits:

- The pSAR will provide greater certainty and clarity for administrators over the objectives against which they are liable, without needing to approach the Court on a frequent basis. For example, it codifies the treatment of the asset pools and principles of distributions to provide the IP with sufficient certainty on the actions to take when pursuing Objective 1 (to ensure the return of relevant funds as soon as is reasonably practicable). There is further likely to be a reduced need for Court direction due to provisions such as the

allocation of pSAR costs. The pSAR also provides the FCA with certain powers to direct the administrator to prevent a situation whereby the administrators are unable to take the necessary actions to wind-up the firm.

- The pSAR benefits consumers and creditors by providing that the administrator, with certain exceptions, identifies and settles any shortfall or excess in an asset pool and by requiring the administrator to take reasonable steps to transfer any identifiable relevant funds held in other accounts to an appropriate relevant funds account. It also requires any shortfall in the asset pool to be borne pro rata by all consumers, which has the potential to speed up the return of relevant funds and reduce the cost of administration. Further, the post-administration receipts provisions both provide certainty to IPs and customers on the treatment of these funds and again has the potential to reduce the time in which the post-administration receipts will be returned to the user or holder.
- The introduction of bar date and hard bar date provisions will allow the administrator to reconcile and return relevant funds much faster than the current insolvency regime allows.
- The continuity of service provisions will ensure that the core operational services that the administrator needs to resolve the institution are accessible and are not withdrawn at the start of the administration. Additionally, the transfer provisions facilitate the rapid transfers of relevant funds and assets to a solvent firm. These provisions allow consumers, whose relevant funds have been transferred, to have continuity of service and faster access to their relevant funds, as these will not be part of protracted insolvency proceedings. Any consumers whose assets are not transferred may benefit from a smaller pool of relevant funds, which will be quicker to distribute, and creditors may benefit from any proceeds from a transfer.
- The benefits from the extension of FSMA Part 24 provisions to PIs/EMIs include: the FCA being able to challenge the appointment of an administrator by a company or its directors that is not appropriate for a PI or EMI; the FCA being able to intervene and take appropriate action to protect consumers by having the right to participate in proceedings relating to a PI/EMI; the FCA being able to take appropriate action to protect consumers in a timely manner through requirements on the IPs to report to the appropriate regulator if they consider a company is carrying (or has carried) on a regulated activity that it was not permitted to do.

However, all the benefits listed above are not quantifiable because the extent of the monetary benefit depends on the specific circumstances of the administration.

Further, it is not possible to quantify an average monetary benefit of the Regulations because this would require making many assumptions in the calculations. Given these many assumptions, we would not be able to arrive at a credible range of figures. Further, given that PIs/EMIs range from very small to large institutions, we would not be able to arrive at a meaningful ‘average’ benefit.

We are aware that the Impact Assessment of the 2017 reforms of the IBSAR (originally introduced in 2011 and now being used as a model for the pSAR) quantified the impact of the benefit, with an annual net benefit to business of £4.73m. This was calculated through discussion with affected groups leading to an estimation that the amendments would reduce the cost of administration by 5-20%. In order to arrive at the annual net benefit to business figure, information was used from 10 firms who had entered the SAR since 2011 to provide sampling data. Given that this data does not exist for PIs/EMIs, as none have yet entered a SAR, we are unable to make estimates using a similar methodology. Therefore, the reasoning in the Impact Assessment for the 2011 IBSAR that it is not possible to quantify the monetised benefits is most applicable to the new pSAR.

5. Please confirm whether your measure could be subject to call-in by BRE under the following criteria. If yes, please provide a justification of why a full impact assessment is not appropriate:

a) Significant distributional impacts (such as significant transfers between different businesses or sectors)

The creditor hierarchy will not change and therefore no creditors will lose out in favour of other creditors, so there should be no difference in distribution and no new transfers.

b) Disproportionate burdens on small businesses

While there may be some costs to PI/EMIs that arise from these measures, regardless of the size of the institution, none of these costs are estimated to be a significant burden.

We do not anticipate that the costs to IPs stated above will over-burden small IPs. IPs must bid to be appointed as special administrator and therefore there is no requirement on them to incur the above costs. However, the pSAR Rules will include provisions on the payment of expenses properly incurred by IPs in performing their functions in the special administration.

c) Significant gross effects despite small net impacts

The effects of the IBSAR have been a reduction in the costs of administration and a quicker return of client assets to customers and monies to creditors. We have not seen any significant gross effects in the IBSAR and do not anticipate any in the pSAR. Further, we do not anticipate any arising from the application of FSMA Part 24 provisions to PIs/EMIs.

d) Significant wider social, environmental, financial or economic impacts

None.

e) Significant novel or contentious elements

None.

Sign-off for de minimis assessment: SCS

I have read the de minimis assessment and I am satisfied that it represents a fair and proportionate assessment of the impact of the measure.

SCS of Resilience & Resolution

Signed: ***Joe Taylor*** Date: 24/03/2021

SCS of Better Regulation Unit

Signed: ***Linda Timson*** Date: 25/03/2021

Sign-off for de minimis assessment: Minister

I have read the de minimis assessment and I am satisfied that it represents a fair and proportionate assessment of the impact of the measure.

Signed: ***John Glen*** Date: 31/03/2021

Further information sheet

Please provide additional evidence in subsequent sheets, as required.